Supreme Court, U.S.
FILED

(1)

No. 94 442 SEP 12 1994

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1994

IN RE: BOSTON POST ROAD LIMITED PARTNERSHIP,
Debtor,

BOSTON POST ROAD LIMITED PARTNERSHIP,
Petitioner,

vs.

FEDERAL DEPOSIT INSURANCE CORPORATION,
Respondent,

EVERGREEN LANDSCAPE; BOYER REALTY MGMT; FLANAGAN ASSOC. APPRAISERS; TINNERELLO RUBBISH REMOVAL; GOTTESDIENER ACCOUNTING; and WATER POLLUTION CONTROL, TOWN OF WATERFORD,
Creditors,

HONOR S. HEATH,
Trustee

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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39 pp

QUESTIONS PRESENTED

1. IN A SINGLE-ASSET CHAPTER 11 CASE, IS THE CLASSIFICATION OF AN UNDERSECURED CREDITOR'S UNSECURED DEFICIENCY CLAIM SEPARATE FROM UNSECURED CLAIMS OF TRADE CREDITORS PROPER UNDER 11 U.S.C. § 1122 OR SHOULD SUCH CLASSIFICATION BE MADE ONLY FOR A GOOD AND COMPELLING BUSINESS REASON?

2. DOES AN IMPAIRED CLASS, AS THAT TERM IS DEFINED UNDER 11 U.S.C. § 1124, INCLUDE A CLASS OF CREDITORS WHOSE INTEREST IS ENHANCED OR ALTERED IN A MANNER WHICH INCREASES THE RIGHTS OF THAT CLASS?

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OPINIONS BELOW

The opinion of the Second Circuit Court of Appeals is reported at 21 F.3d 477 (2d Cir. 1994) and appears in Appendix (Appx.) at 36-64. The denial of petition for rehearing in the Second Circuit Court of Appeals is unreported and appears in Appx. at 101-02, 103-04.

The opinion of the United States District Court for the District of Connecticut is reported at 154 B.R. 617 (1993) and appears in Appx. at 17-35.

The opinion of the Bankruptcy Court is reported at 145 B.R. 745 (1992) and appears in Appx. at 1-16.

JURISDICTION

The judgment of the Court of Appeals was entered on March 30, 1994. A petition for rehearing was denied on June 14, 1994. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) which appears in Appx. at 140.

STATUTORY PROVISIONS

This case involves the following statutes which are set forth in full in the Appendix to this petition:

Statutory Provision	*Appendix*
28 U.S.C. § 1254	140
11 U.S.C. § 1111	141-42
11 U.S.C. § 1122	143
11 U.S.C. § 1123	144-47
11 U.S.C. § 1124	148-49
11 U.S.C. § 1126	150-51
11 U.S.C. § 1129	152-57

STATEMENT OF THE CASE

This appeal involves basically two parties: a debtor whose only significant asset is an office complex in Waterford, Connecticut and a lender who possesses a multi-million dollar lien on that property.

The Petitioner, Boston Post Road Limited Partnership, is a limited partnership formed pursuant to the Connecticut Uniform Limited Partnership Act, Connecticut General Statutes § 34-9 *et seq.* (ULPA) and consisting of a single individual general partner, George Boyer of Stonington, Connecticut and a single limited partner, George Myers of Mystic, Connecticut. Both the general and limited partners are full-time real estate professionals. Boston Post Road was formed on September 19, 1984 for the sole purpose of acquiring, owning and managing a single real estate project located at 161 Boston Post Road in Waterford,

Connecticut.

In March of 1988, some four years after the acquisition of the property, Boston Post Road refinanced its mortgage with then-Connecticut Bank & Trust Company, N.A. (CBT). That mortgage was in the original principal amount of $1,600,000 and carried an interest rate of "Prime Rate" plus ¾%, adjustable on an immediate change date basis. The original monthly mortgage payments of interest and principal were set at $13,653. This equated to an annual cash payment from the project of $163,836 to service the mortgage debt. The net income from the project, at least at that time, was sufficient to carry the debt service with a small equity cushion.

Subsequently, the prime rate as set by CBT began to escalate and within a short period of time it reached 12¼

percent. Shortly thereafter, the net income from the project became insufficient to meet the annual debt service which increased almost $40,000 per year to $203,556. This change in debt service amounted to roughly a 20 percent increase in less than one year.

As the net income from the project became insufficient to fund this increase in added expense in a relatively short period of time, the partners subsidized the mortgage payments from their own funds. Additionally, during this period, Boston Post Road attempted to obtain relief from CBT by way of interest reductions and principal deferral. CBT refused any relief and soon the mortgage payments fell behind by one month. When the real estate market collapsed in 1990, the mortgage payments fell three months behind. CBT then commenced foreclosure

proceedings.

During the foreclosure, a receiver of rents took over the control and management of the property for approximately one year. In January of 1991, the Comptroller of Currency of the United States declared CBT to be insolvent and appointed the Federal Deposit Insurance Corporation (FDIC) as the receiver for CBT. Immediately upon accepting its appointment as receiver, the FDIC continued to press the then-pending foreclosure action. Boston Post Road, in response to the FDIC's efforts to complete its foreclosure, prepared and filed a *pro se* petition for relief under Chapter 11 of the Bankruptcy Code.

On August 12, 1992, a hearing was held to confirm Boston Post Road's Second Amended Plan of Reorganization which proposed a "cramdown" seeking to

retain possession and full ownership of the property and to force a write-down of the obligation owed to the FDIC. *See* Appx. at 105-39.

Boston Post Road's plan included three separate classes of unsecured claims, one of which was represented by the FDIC deficiency claim which consisted of the unsecured portion of its lien against Boston Post Road's property. The other two classes represented unsecured trade creditor interests and unsecured creditors consisting of tenants whom Boston Post Road contended were likewise impaired under the plan.

Prior to the hearing to confirm the plan, the FDIC did not make the 1111(b) election and instead filed various objections to the Plan, including that the separate classification of its unsecured deficiency claim from

unsecured trade creditors was *patently* improper and also that the class of tenants was not impaired and therefore could not vote on the plan.

The case was initially brought in Federal Bankruptcy Court pursuant to jurisdiction granted to the court by 28 U.S.C. § 157(b)(1). On October 2, 1992, the Bankruptcy Court entered a final order denying the confirmation of Boston Post Road's Second Amended Plan of Reorganization. *See* Appx. at 1-16. The basis of the order of the Bankruptcy Court centered primarily around the plan's proposed separate classification of the FDIC deficiency claim from those of trade creditors. On October 9, 1992, Boston Post Road filed its notice of appeal from that decision to the United States District Court for the District of Connecticut.

On June 21, 1993, District Court Judge Alan H. Nevas issued a memorandum of decision affirming the decision of the Bankruptcy Court in denying confirmation of Boston Post Road's Second Amended Plan of Reorganization (Memorandum of Decision) and on June 23, 1993 judgment entered against Boston Post Road affirming the order of the Bankruptcy Court. *See* Appx at 17-35. On August 18, 1993, Boston Post Road gave notice of its appeal to the United States Court of Appeals for the Second Circuit from the June 23, 1993 judgment of the District Court affirming the decision of the United States Bankruptcy Court, which judgment acted as a final judgment for purposes of appellate jurisdiction to the Court

of Appeals.[1]

On March 30, 1994 the United States Court of Appeals for the Second Circuit affirmed the decision of the District Court. Boston Post Road petitioned the United States Court of Appeals for the Second Circuit for rehearing and further suggested to the Court that the action be reheard

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[1] *See, e.g., In re Mason*, 709 F.2d 1313 (9th Cir. 1983); *see also In re Blankemeyer*, 861 F.2d 191, 193 (8th Cir. 1988); *In re Pine Assoc., Inc.*, 733 F.2d 208 (2d Cir. 1984); *Penn Terra, Ltd. v. Department of Env. Resources*, 733 F.2d 267 (3d Cir. 1984); *In re Leimer*, 724 F.2d 744 (8th Cir. 1984) (applying the pragmatic test of finality for purposes of appeal of right to the District Court); *In re American Mariner Indus., Inc.*, 734 F.2d 426 (9th Cir. 1984); *In re White*, 727 F.2d 884 (9th Cir. 1984) (applying a "need-for-immediate-review" test); *In re Comer*, 716 F.2d 168 (3d Cir. 1983); *Borg-Warner Acceptance Corp. v. Hall*, 685 F.2d 1306 (11th Cir. 1982); *In re Taddeo*, 685 F.2d 24 (2d Cir. 1982); *John T. Mather Memorial Hospital of Port Jefferson, Inc. v. Pearl*, 723 F.2d 193, 194 n.1 (2d Cir. 1983).

en banc. On June 14, 1994 the United States Court of Appeals for the Second Circuit denied Boston Post Road's motion for rehearing. *See* Appx. at 101-02, 103-04. On August 15, 1994 Boston Post Road petitioned the United States Court of Appeals for the Second Circuit for a stay pending this petition for Certiorari. Boston Post Road now seeks this Supreme Court to issue a writ of certiorari to the United States Court of Appeals for the Second Circuit.

REASONS FOR GRANTING THE WRIT

IN LIGHT OF A CLEAR CONFLICT OF AUTHORITY BETWEEN THE CIRCUIT COURTS, THIS COURT SHOULD DETERMINE WHETHER IN A SINGLE-ASSET CHAPTER 11 CASE, THE CLASSIFICATION OF AN UNDERSECURED CREDITOR'S UNSECURED DEFICIENCY CLAIM SEPARATE FROM UNSECURED CLAIMS OF TRADE CREDITORS IS PROPER UNDER 11 U.S.C. SECTION 1122.

The issue raised in this appeal is the subject of a jurisdictional split between the Circuit Courts. The Supreme Court could resolve this disparity by granting this petition for Writ of Certiorari. The question was presented to the United States Court of Appeals for the Second Circuit as one of first impression which that Court recognized as a "'hot topic' among practitioners and in the academic community," *see In re Boston Post Road Limited Partnership*, 21 F.3d 477, 481 (2d Cir 1994) (Appx. at 36-

64).

The decision of the Second Circuit explicitly relied on the Fifth Circuit's decision on the same issue in *In Re Greystone III, Joint Venture*, 995 F.2d 1274 (5th Cir. 1991), *cert. denied*, ___ U.S. ___, 113 S.Ct. 72, 121 L.Ed.2d 37 (1992), which the Second Circuit Court found to be the "preeminent case on the question." *In Re Boston Post Road*, 21 F.3d at 482.

The Court of Appeals, Milton Pollack, Senior District Judge, sitting by designation, held that: (1) separate classification of unsecured claims solely to create impaired assenting class for purposes of cramdown will not be permitted, and debtor must instead adduce credible proof of legitimate reason for separate classification of similar claims; (2) different origins of Federal Deposit Insurance

Corporation's (FDIC's) unsecured deficiency claim and general unsecured claims of trade creditors did not alone justify separate segregation; (3) that the debtor failed to present any evidence of legitimate business reason for separate classification of similarly situated unsecured creditor claimants for purposes of cramdown; and (4) that residential tenants of debtor whose security deposits debtor was holding under continued leases were administrative claimants not entitled to vote on plan of reorganization.

The reasoning of the Second Circuit court was predicated in the other circuits having generally held that separate classification of similar claims is permissible only upon proof of a legitimate reason for separate classification, and that separate classification to gerrymander an affirmative vote is impermissible. *See, e.g., Greystone III,*

995 F.2d at 1279. ("[T]hou shalt not classify similar claims differently in order to gerrymander an affirmative vote on a reorganization plan.")

The Second Circuit noted:

> All the circuit courts that have heretofore visited the question of when similar claims may be classified separately have held that similar claims may not be separately classified solely to engineer an assenting impaired class: [I]f § 1122(a) permits classification of "substantially similar" claims in different classes, such classification may only be undertaken for reasons independent of the debtor's motivation to secure the vote of an impaired, assenting class of claims. *Greystone III*, 995 F.2d 1274, 1279 (5th Cir. 1991), *cert. denied*, __ U.S. __, 113 S.Ct. 72, 121 L.Ed. 2d 37 (1992); [A]lthough separate classification of similar claims may not be prohibited, it "may only be undertaken for reasons independent of the debtor's motivation to secure the vote of an impaired, assenting class of claims." *Travelers Ins. Co. v. Bryson Properties, XVIII* (*In re Bryson Properties, XVIII*), 961 F.2d 496, 502 (4th Cir.) (*quoting Greystone III*, 995 F.2d at 1279), *cert. denied*, __ U.S. __, 113 S.Ct. 191, 121 L.Ed.2d 134 (1992); [I]f the classifications are designed to manipulate class voting . . . , the plan cannot be

confirmed. *Olympia & York Florida Equity Corp. v. Bank of New York* (*In re Holywell Corp.*), 913 F.2d 873, 880 (11th Cir. 1990); The debtor's discretion to place similar claims in different classes is not unlimited, however. Classifications designed to manipulate class voting must be carefully scrutinized. There is potential for abuse when the debtor has the power to classify creditors in a manner to assure that at least one class of impaired creditors will vote for the plan, thereby making it eligible for the cram down provisions. *Hanson v. First Bank of South Dakota, N.A.*, 828 F.2d 1310, 1313 (8th Cir. 1987); Unless there is some requirement of keeping similar claims together, nothing would stand in the way of a debtor seeking out a few impaired creditors (or even one such creditor) who will vote for the plan and placing them in their own class. *Teamsters Nat'l Freight Industry Negotiating Comm. v. U.S. Truck Co.* (*In re U.S. Truck Co.*), 800 F.2d 581, 586 (6th Cir. 1986). Indeed, some courts have gone even further, holding that a plan must classify all substantially similar claims together, regardless of the debtor's intent. *See Granada Wines, Inc. v. New England Teamsters and Trucking Indus. Pension Fund*, 748 F.2d 42, 46 (1st Cir. 1984).

The Second Circuit also held that a reading of Section 1122 in the context of the rest of the Code suggests

that discretionary separate classification of similar claims would undermine the Section 1111(b) election:

> As explained above, Section 1111(b) of the Bankruptcy Code permits an undersecured creditor to choose whether (i) its claim should be divided into a secured claim equal to the court-determined value of the collateral and an unsecured claim for the deficiency, or (ii) its entire claim should be considered secured. The purpose of the Section 1111(b) election is to allow the undersecured creditor to weigh in its vote with the votes of the other unsecured creditors. Allowing the unsecured trade creditors to constitute their own class would effectively nullify the option that Congress provided to undersecured creditors to vote their deficiency as unsecured debt.
>
> Finally, approving a plan that aims to disenfranchise the overwhelmingly largest creditor through artificial classification is simply inconsistent with the principles underlying the Bankruptcy Code. A key premise of the Code is that creditors holding greater debt should have a comparably greater voice in reorganization. Thus, although Debtor protests that prohibiting it from separating the unsecured claims of the FDIC from those of its trade creditors will effectively bar single asset debtors from utilizing the Code's cramdown provisions, Debtor fails to

> persuade that a single-asset debtor should be able to cramdown a plan that is designed to disadvantage its overwhelmingly largest creditor. Chapter 11 is far better served by allowing those creditors with the largest unsecured claims to have a significant degree of input and participation in the reorganization process, since they stand to gain or lose the most from the reorganization of the debtor. This Court thus holds that separate classification of unsecured claims solely to create an impaired assenting class will not be permitted; the debtor must adduce credible proof of a legitimate reason for separate classification of similar claims.

During the appeal, Boston Post Road urged the Second Circuit court to adopt the reasoning of *In re D & W Realty Corp.*, 156 B.R. 140, 141 & n.3 (Bankr. S.D.N.Y. 1993), *rev'd*, 165 B.R. 127 (S.D.N.Y. 1994) (holding that "separate classification is not only appropriate, it is in fact mandated by the Bankruptcy Code and Rules") and *In re SM 104, Ltd.*, 160 B.R. 202, 218-19 (Bankr. S.D.Fla. 1993) (holding that unsecured deficiency claims created by §

1111(b) are not substantially similar to other unsecured claims, while asserting that the "circuit courts and the majority of district and bankruptcy courts have missed the forests for the trees").

Both of these decisions found separate classification to be not only permissible under the Code, but mandatory. The Second Circuit dismissed the reasoning of these two cases by citing that no Circuit court had adopted a similar reading of the Code. *In re Boston Post Road*, 21 F.3d at 482.

Significantly, during the pendency of the decision by the Second Circuit Court of Appeals, the Seventh Circuit on March 18, 1994 did that which the Second Circuit noted had not been done. In *In re Woodbrook Assoc.*, 19 F.3d 312 (7th Cir. 1994) (affirming decision of lower court on other

grounds), the United States Court of Appeals for the Seventh Circuit rendered a decision rejecting the reasoning of the Fifth Circuit in *Greystone*. A copy of the Seventh Circuit decision is found in Appx. at 65-100. The Seventh Circuit's decision in *Woodbrook*, which is in direct conflict with the Fifth Circuit's prior ruling on the same issue in *Greystone*, and which is likewise in direct conflict with that issued by the Second Circuit in this matter, held separate classification to be mandatory under the Code. *In re Woodbrook Assoc.*, 19 F.3d 312, 319 (7th Cir. 1994).

In *Woodbrook*, the Seventh Circuit recognized that the "one clear rule" engendered by *Greystone* was not an easy one to apply

> since it is not about "classifying similar claims"; it is about the debtor's purpose. Similarity is not a precise relationship, and the elements by which we judge similarity or

> resemblance shifts from time to time in bankruptcy.

In re Woodbrook, 19 F.3d at 318. The Court continued:

> Significant disparities do exist between the legal rights of the holder of a sec. 1111(b) claim and the holder of a general unsecured claim which render the two claims not substantially similar and which preclude the two from being classified together under sec. 1122(c). Thus, we cannot accept the proposition implicit in *Greystone* that separate classification of a sec. 1111(b) claim is nearly conclusive evidence of a debtor's intent to gerrymander an affirmative vote on confirmation. These disparities in rights stem from the most obvious difference between the two claims: a general unsecured claim exists in all chapters of the Code, while a sec. 1111(b) claim exists only as long as the case remains in Chapter 11 and, once converted to a Chapter 7 case, recovery is limited to its collateral. *Compare* 11 U.S.C. sec. 103(f) with 11 U.S.C. sec. 502(b)(1).
>
> * * *
>
> This legal difference between the two claims also can lead to anomalous results when

> applying other sections of the Code to a class containing both sec. 1111(b) claimants and general unsecured claimants. . . . These anomalies are all clearly set out in Judge Ginsberg's well-reasoned opinion. *In re SM 104, Ltd.*, 160 B.R. 202, 219-21 (Bankr. S.D. Fla. 1993).
>
> The drafters of the Bankruptcy [Code] did not intend these results. We find that, at least where the debtor is a partnership comprised of a fully encumbered single asset, the legal rights of a sec. 1111(b) claimant are substantially different from those of a general unsecured claimant. Accordingly, we hold that secs. 1111(b) and 1122(a) not only permit but require separate classification of . . . sec. 1111(b) unsecured deficiency claims. . . .

Id. at 319.

The reasoning adopted by the *SM 104, Ltd.* and *Woodbrook* courts makes it clear that the Code, *by its very terms*, requires separate classification of an undersecured creditor's unsecured claim in a Chapter 11. There is no

doubt that this issue, which is divisive amongst the Circuits, is also one that will not go away. Additionally, the current line-up of the Circuits, with no definitive pronouncement from this Court, will encourage single asset chapter 11 debtors to forum shop to those circuits where they will be dealt with most favorably. This is precisely the situation which 28 U.S.C. § 1254(1) is intended to address. For this reason alone, this Court should grant this petition for a writ of certiorari to the United States Court of Appeals for the Second Circuit on the issues raised herein.

AN IMPAIRED CLASS, AS THAT TERM IS DEFINED UNDER 11 U.S.C. § 1124, INCLUDES A CLASS OF CREDITORS WHOSE INTEREST IS ENHANCED OR ALTERED IN A MANNER WHICH INCREASES THE RIGHTS OF THAT CLASS.

Separate and apart from the foregoing, the Second

Circuit erroneously declined to address this second issue by holding that residential security deposit holders were not entitled to vote on the Petitioner's Plan of Reorganization. In so holding, the Second Circuit relied on *Greystone*. This holding constituted an erroneous interpretation of the Code, and placed an unnecessary restriction thereon, because the issue surrounding the classification of residential security holders is governed not by the *Greystone* decision, but rather by the decisions of *In re Bryson Properties*, 961 F.2d 496 (4th Cir. 1992) and *In re River Village Assoc.*, 24 Bankr. 1400 (E.D. Pa. 1993).

In its Plan, Boston Post Road identified its Class 3 claim holders of security deposits to be impaired, as that term is defined under the Code, and hence able to vote on the Plan. The Respondent argued that the class was not

impaired because its legal interest was enhanced, and thus *unaltered*, by the Plan. The Code does not make this distinction.

The legal interests of the Class 3 claim holders were, in fact, altered or impaired. The Plan provided that the Class 3 claim holders will receive, as a marketing tool, and as an incentive to continue renting within the project, as well as to attract new tenants, interest on their security deposits at a rate of eight (8%) percent which is higher than the statutory rate of five and a quarter (5¼%) percent. *See* Appx. at 105-39; Conn. Gen. Stat. § 47a-21(i) (West 1994)

The Code does not limit its definition of impairment to only those claims which are somehow hindered or harmed by the plan. Section 1124 defines "impairment" as follows:

> Except as provided in Section 1123(a)(4) of this title, a class of claims or interests is impaired under a plan unless, with respect to each claim or interest of such class, the plan
>
> > (1) leaves *unaltered* the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest;
> >
> > * * *

11 U.S.C. § 1124(1) [emphasis added].

11 U.S.C. § 1126(f) states that a class of claims which is *un*impaired is deemed to have accepted a plan. Because all classes of claims must either accept or be unimpaired under a plan, *see* 11 U.S.C. § 1129(a)(8), unless the "cramdown" powers of 11 U.S.C. § 1129(b) are invoked, a determination of "impairment" is instrumental in examining a plan in the first instance.

During the appeal to the Second Circuit, *amicus*

curiae, Federal Home Loan Mortgage Corporation ("FHLMC"), relying on the *Greystone* decision, asserted in its brief that it was not necessary for the Court to reach this issue. The FHLMC argued that such deposit holders were not a proper class and therefore not entitled to vote in the first instance. In response, the Petitioner asserted that given the express language of 11 U.S.C. § 507(a)(6) and 11 U.S.C. § 1129(a)(9), which identify deposit holders as a class entitled to vote, that the *Greystone* decision focusing on 11 U.S.C. § 365 and § 1126(c) with respect to the treatment of security deposit holders, is inappropriate and misplaced.

Specifically, Section 507(a)(6) provides that the following "claim" has priority:

> Sixth, allowed unsecured claims of individuals, to the extent of $900 for each

> such individual, arising from the deposit, before the commencement of the case, of money in connection with the purchase, lease, or rental of property, or the purchase of services, for the personal, family, or household use of such individuals that were not delivered or provided.

Similarly, Section 1129(a)(9) provides, in pertinent part, that the court shall confirm a plan only if:

> Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that --
>
> * * *
>
> (B) with respect to a claim of a kind specified in section . . . 507(a)(6) of this title, each holder of a claim of such class will receive --
>
> (i) if such class has accepted the plan, deferred cash payments of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

> (ii) if such class has not accepted the plan, cash on the effective date of the plan equal to the allowed amount of such claim. . . .

The Second Circuit declined to reach the issue of what constitutes "impairment" under the Code by concluding that under Code, unexpired leases must be assumed or rejected by the debtor, and when the debtor does neither, leases continue in effect and therefore lessees have no provable claim against bankruptcy estate and that accordingly, obligations assumed by the debtor under continued leases constitute post-petition administrative claims, which do not give their holders right to vote on plan of reorganization.

Petitioner respectfully asserts that this decision was incorrect in light of the express language contained in 11

U.S.C. § 507(a)(6) and 11 U.S.C. § 1129(a)(9). Accordingly, Class 3 was a proper impaired class which voted in favor of the Petitioner's Plan of Reorganization and therefore, the said Plan should have been confirmed by the courts below.

CONCLUSION

The order of a Writ of Certiorari should be issued in light of the conflict which has emerged from United States Courts of Appeals which have reached the issue of separate classification under Section 1111(b) of the United States Bankruptcy Code. This Supreme Court should grant the petition for certiorari to determine which analysis is correct and to resolve a growing jurisdictional disparity.

RESPECTFULLY SUBMITTED,
THE PETITIONER,
BOSTON POST ROAD LIMITED PARTNERSHIP

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IN THE
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OCTOBER TERM, 1994

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Petitioner,

vs.

FEDERAL DEPOSIT INSURANCE CORPORATION,
Respondent,

EVERGREEN LANDSCAPE; BOYER REALTY MGMT; FLANAGAN ASSOC. APPRAISERS; TINNERELLO RUBBISH REMOVAL; GOTTESDIENER ACCOUNTING; and WATER POLLUTION CONTROL, TOWN OF WATERFORD,
Creditors,

HONOR S. HEATH,
Trustee

APPENDIX TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT

In re	:	CHAPTER 11
BOSTON POST ROAD	:	
LIMITED PARTNERSHIP,	:	CASE NO.:
	:	91-23498 (RLK)
Debtor	:	
----------x		October 2, 1992

MEMORANDUM OF DECISION AND ORDER RE: OBJECTION TO CONFIRMATION OF PLAN

James C. Graham and Sean W. Gilligan, Pepe & Hazard, Hartford, Conn., for F.D.I.C., Receiver for the New Connecticut Bank and Trust Co., N.A., f/k/a The Connecticut Bank and Trust Co., N.A., objecting creditor.

S. Joel Suisman and Andrew J. Brand, Suisman, Shapiro, Wool, Brennan & Gray, P.C., New London, Conn., for debtor.

ROBERT L. KRECHEVSKY, Chief Judge.

I.

At a chapter 11 confirmation hearing on a debtor's plan, a creditor appeared and objected to confirmation, contending, inter alia, that the debtor gerrymandered classes

in the preparation of its plan of reorganization.[1] The court, for reasons that follow, concludes that the plan's classification of creditors is improper and that no truly-impaired class, which does not include insiders, has voted to accept the plan. Accordingly, the objection is sustained and confirmation of the plan denied.[2]

II.

BACKGROUND

Boston Post Limited Partnership, the debtor, was formed in 1984 to acquire and manage a residential and office complex located at 161 Boston Post Road in Waterford, Connecticut (the property). The debtor, on

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[1]Code § 1128. Confirmation hearing. (a) After notice, the court shall hold a hearing on confirmation of a plan. (b) A party in interest may object to confirmation of a plan.

[2]The debtor and creditor agreed at the confirmation hearing to submit the issues discussed *infra* to the court for a ruling. If the court had determined all issues in favor of the debtor, the confirmation hearing would have reconvened.

March 17, 1988, mortgaged the property to Connecticut Bank and Trust Company (CBT) to secure a loan of $1,600,000. The debtor thereafter defaulted in the mortgage payments, and CBT, on July 20, 1990, started a mortgage-foreclosure action in state court. CBT itself, on January 6, 1991, had its assets seized by the United States Comptroller of Currency, and The Federal Deposit Insurance Corporation (FDIC) became the holder of the debtor's mortgage.

The FDIC pursued the foreclosure action and, on August 1, 1991, the Connecticut Superior Court entered a judgment of strict foreclosure, setting October 28, 1991 as the debtor's law day for redemption. On that date, the debtor filed a chapter 11 petition in this court.

The debtor's Second Amended Plan of Reorganization (Plan) contains seven classes. In relevant part, the Plan proposes to pay over a six-year term without interest unsecured trade creditors (Class 4) whose claims,

not counting insiders, total about $5000; to pay the FDIC's $500,000.00 mortgage deficiency claim (Class 5) without interest following the earlier of a sale of the property or the fifteenth year following plan confirmation;[3] and to pay the FDIC's $1,445,000 secured Claim (Class 2) over a 15-year term, utilizing negative amortization with a balloon payment at the end of the fifteenth year following confirmation. The Plan places the debtor's sole limited partner in Class 6, and the debtor's sole general partner in Class 7. Class 3 includes residential tenants of the property who have placed security deposits with the debtor. The Plan provides that Class 3 members shall receive interest on their security deposits at the annual rate of 8%, rather than the 5 1/4 %

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[3]During the hearing on approval of the debtor's disclosure statement, the FDIC chose not to make a Code § 1111(b)(2) election, thereby allowing its claim to be divided into secured and unsecured segments. *See* Fed. R. Bankr. P. 3014.

rate mandated by Conn.Gen.Stat. § 47a-21.[4] The Plan describes all classes as impaired. (Class 1 has turned out to be a class without any members.).

The parties agree, that for the purposes of the confirmation hearing, the property has a value of $1,445,000, and that the FDIC's debt totals about $1,945,000. As a result, the Class 5 FDIC unsecured claim is approximately $500,000, with the Class 3 FDIC secured claim equalling $1,445,0000.

The members of Class 3 (tenants), Class 6 (limited partner) and Class 7 (general partner) voted to accept the Plan. The FDIC, as the sole member of Classes 2 and 4, voted to reject the Plan.

The FDIC's objection contends that Class 3 is not a

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[4]Conn.Gen.Stat. § 47a-21 contains detailed provisions designed to safeguard security deposits paid by tenants to landlords by requiring the landlord to place such deposits in segregated escrow accounts at banks to accrue interest for the benefit of the tenant. The statute contains civil and criminal penalties for its violation.

validly-impaired class, and that the trade-creditor votes in Class 4 and the FDIC's vote in Class 5 should have been combined as creditors holding substantially similar unsecured claims, in which case the FDIC's negative vote of $500,000 would have resulted in a negative vote for the class of unsecured creditors.[5] If this is so, the FDIC asserts, no impaired class of noninsiders would have accepted the Plan, thereby requiring that confirmation of the Plan be denied. *See* Code § 1129(a)(10) ("The court shall confirm a plan only if . . . at least one impaired class of claims that is impaired under the plan has accepted the plan, determined without including any acceptances of the plan by any insider.").

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[5]Code § 1126. Acceptance of plan.

. . . . . .

(c) A class of claims has accepted a plan if such plan has been accepted by creditors, . . . that hold a least two-thirds in amount and more that one- half in number of the allowed claims of such class held by creditors . . . that have accepted or rejected such plan.

III.

DISCUSSION

A.

Class 3 Does Not Constitute An Impaired Class

The Plan provides that the security deposits placed by the residential tenants with the debtor receive additional annual interest of 2 3/4% above that statutorily mandated for such deposits. In no other respect are the tenant's rights affected. This additional interest, according to the debtor, impairs these Class 3 members under the definition of impairment contained in Code § 1124(1): . . . a class of claims or interests is impaired under a plan unless, with respect to each class or interest of such class, the plan -- (1) leaves unaltered the legal, equitable and contractual rights to which such claim or interest entitles the holder of such claim or interest;

The debtor argues that by paying more interest on the security deposits than required by law, the members of

Class 3 have had their interests altered, and thus impaired. In support of this contention, the debtor cites *In re Club Assocs.*, 107 B.R. 385 (Bankr. N.D. Ga. 1989); *In re Jones*, 32 B.R. 951 (Bankr. D. Utah 1983); *In re Barrington Oaks Gen. Partnership*, 15 B.R. 952 (Bankr. D. Utah 1981); and 5 COLLIER ON BANKRUPTCY ¶ 1124.03 at 1124-13 (15th Ed. 1992) as standing for the proposition that any alteration in the rights of a creditor, including giving the creditor additional benefits, constitutes impairment.

The debtor's reliance on these authorities is misplaced. None of the cited holdings, nor Colliers, supports the proposition claimed by the debtor. In *In re Club Assocs.*, *supra*, a plan modified a secured creditor's claim by extending the maturity date of a promissory note, requiring written notice of default, and by giving the debtor an opportunity to cure such default. The court determined such alterations impaired the creditor's claim. The holding contains no discussion of whether additional interest

payments to a creditor constitute impairment. *In re Jones*, *supra*, and *In re Barrington Oaks Gen. Partnership*, *supra*, are similarly inapposite. Although Colliers, *supra*, does contain the statement "[n]ote that any alteration of rights constitutes impairment even if the value of the rights is enhanced", there is no elaboration. Whatever the reach of such statement, it does not apply to the present matter. The tenant's rights here are unaffected The tenants have been, and hereafter will be, entitled to the return of their segregated security deposits plus 5 1/4% accrued interest upon their vacating the property.

The debtor unconvincingly asserts that it wishes to pay the additional interest of 2 3/4% "as a marketing tool" to maintain present tenants and attract new ones. Debtor's Reply Brief, at 11. I conclude that to provide for additional interest to be paid on tenants' security deposits in order to create an impaired class is to turn the doctrine of impairment (as well as that of classification, *see* section B

infra) on its head and is totally impermissible. If the debtor were correct, as the FDIC points out, any time a plan proponent needed an impaired class for a favorable vote, the debtor would simply add $1.00 to such class members' claims -- a transparent and unacceptable stratagem.

B.

Classification of The FDIC's Unsecured Claim Separate From Unsecured Claims of Trade Creditors Is Improper

Code § 1122 governs the classifications of claims and reads in full as follows: (a) Except as provided in subsection (b) of this section, a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class. (b) A plan may designate a separate class of claims consisting only of every unsecured claim that is less than or reduced to an amount that the court approves as reasonable and necessary for administrative convenience.

Case law has established that § 1122 does not, *per se*, prevent classification of substantially similar claims in separate classes. *See, e.g., Barnes v. Whelan*, 689 F.2d 193, 201 (D.C. Cir. 1982) ("[S]ection 1122(a) does not prohibit [the debtor] from grouping his unsecured obligations according to whether or not a codebtor is present."). The courts, however, have uniformly prohibited a debtor from classifying similar claims differently in order to gerrymander an affirmative vote in favor of a reorganization plan. "[T]here must be some limit on a debtor's power to classify creditors in such a manner. The potential for abuse would be significant otherwise. Unless there is some requirement of keeping similar claims together, nothing would stand in the way of a debtor seeking out a few impaired creditors (or even one such creditor) who will vote for the plan and placing them in their own class." *In re U.S. Truck Co., Inc.*, 800 F.2d 581, 586 (6th Cir. 1986). *See also In re Bryson Properties, XVIII*, 961 F.2d 496, 502 (4th Cir. 1992),

petition for cert. filed, 61 U.S.L.W. 3061 (U.S. July 16, 1992) (No. 92-108); *In re Greystone III Joint Venture*, 948 F.2d 134, 139 (5th Cir. 1991) (as amended), *petition for cert. filed*, 60 U.S.L.W. 3843 (U.S. May 27, 1992) (No. 91-1902); *In re Holywell Corp.*, 913 F.2d 873, 880 (11th Cir. 1990).

In the Plan before the court, the debtor had placed the FDIC's unsecured claim of $500,000 in a class separate from the class of unsecured-trade-creditor claims whose claims total $5,000. To support such separate classification, the debtor argues that (1) the trade-creditors' claims are dissimilar to the FDIC's deficiency claim because the trade creditors' claims arose from the operation of the debtor's business, not from the decline in value of the property; and (2) if the trade creditors are not afforded special treatment, they may not do business with the debtor in the future. See Debtor's Reply Brief at 21-22.

In situations involving chapter 11 debtors, where one

lender holds an unsecured deficiency claim that dominates the vote of the unsecured creditors, the overwhelming weight of authority holds that it is improper to classify separately the unsecured deficiency claim. *Greystone III, supra*, is the leading case explicitly rejecting both of the contentions made here by the debtor to support separate classification.

In *Greystone III*, the debtor's only significant asset was an office building valued at $5,825,000 encumbered by a mortgage lien of $9,325,000. The debtor's trade creditors held claims of about $10,000. The plan classified the unsecured deficiency claim separately from the claims of the trade creditors, the debtor arguing that separate classification was founded on a "legal difference" between the two types of claims. The secured creditor, under Texas law, had no personal recourse against the debtors. Under Code § 1111(b), however, the undersecured creditor was able to elect recourse status and, thus, vote as an unsecured creditor.

The debtor contended that the unsecured deficiency claim thus arose by statute unlike the claims of the trade creditors. *Greystone III* rejected this analysis. "The State law distinction between Code-created unsecured deficiency claims and other unsecured claims does not alone warrant separate classification." *In re Greystone III*, 948 F.2d at 140. In response to the debtor's additional argument that "realities of the business" justify separate classification and different treatment, the court stated: "There is no evidence in the record of a limited market in Austin for trade goods and services. Nor is there any evidence that Greystone would be unable to obtain any of the trade services if the trade creditors did not receive preferential treatment under the plan." *Id.* at 141. *See also In re Lumber Exch. Bld. Ltd. Partnership*, 968 F.2d 647, 649-50 (8th Cir. 1992); *In re Bryson Properties, XVIII*, 961 F.2d at 501-02; *In re Washington Assocs.*, 141 B.R. 275, 282-87 (Bankr. E.D.N.Y. 1992); *In re Cantonwood Assocs. Ltd. Partnership*, 138

B.R. 648, 653-57 (Bankr. D. Mass. 1992); *Piedmont Assocs. v. Cigna Property & Casualty Ins.*, 132 B.R. 75, 78 (N.D. Ga. 1991); *In re Waterways Barge Partnership*, 104 B.R. 776, 783-86 (Bankr. N.D. Miss. 1989); *In re Pine Lake Village Apartment Co.*, 19 B.R. 819, 828-31 (Bankr. S.D.N.Y. 1982).

The debtor's final argument that "the separation of the Class 3 creditors from the FDIC's unsecured claim is permitted by Section 1122(b)" (*e.g.* "for administrative convenience"), Debtor's Reply Brief at 24, is too attenuated to require any discussion.

The FDIC's unsecured deficiency claims approximates $500,000 and that of the unsecured trade creditors who voted to accept the plan approximates only $5,000. To paraphrase the *Greystone III* court, 948 F.2d at 141, the debtor's classification scheme effectively disenfranchised the FDIC's deficiency claim, a result sanctioned neither by the Code nor by case law.

IV.

CONCLUSION

There being no validly-classified, noninsider, impaired class that has accepted the debtor's Plan, the objection of the FDIC is sustained, and confirmation of the Plan is denied. This ruling makes it unnecessary to discuss the FDIC's further objections concerning the propriety of utilizing negative amortization in the treatment of the FDIC's secured claim, and the existence *vel non* of the "new value" exception to the absolute priority rule. It is

SO ORDERED.

UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

In re BOSTON POST ROAD LIMITED PARTNERSHIP Debtor	: : : : :	CIV. NO.: 2:92CV892 (AHN)
----------x		
BOSTON POST ROAD LIMITED PARTNERSHIP v.	: : : :	
FEDERAL DEPOSIT INSURANCE CORPORATION as Receiver for the New Connecticut Bank and Trust Company	: : : : : : :	MAY 28, 1993
----------x		

RULING ON APPEAL FROM BANKRUPTCY ORDER

Andrew J. Brand, Suisman, Shapiro, Wool, Brennan & Gray, PC, New London, CT, for plaintiff.

Walter E. Paulekas, Levin & D'Agostino, Hartford, CT, for defendant.

NEVAS, District Judge.

Appellant Boston Post Road Limited Partnership ("Debtor"), appeals the Bankruptcy Court's October 2, 1992 order, the Honorable Robert L. Krechevsky, Judge, denying confirmation of the Debtor's second amended plan for reorganization under Chapter 11 of the Bankruptcy Code (the "Order") 145 B.R. 745.

The Debtor challenges the Bankruptcy Court's findings concerning the propriety of the Debtor's proposed classification of claims under 11 U.S.C. § 1129. For the reasons that follow, the Order denying confirmation is affirmed.

I. Background

The Debtor is a limited partnership formed for the purpose of acquiring and managing a real estate project located at 161 Boston Post Road in Waterford, Connecticut. In 1988, the Debtor mortgaged the property to the New Connecticut Bank and Trust ("CBT") to secure a

$1,600,000.00 loan. The Debtor defaulted in the mortgage payments and CBT initiated a foreclosure action in state court. The FDIC subsequently became the holder of the Debtor's mortgage and pursued foreclosure against the Debtor. On August 1, 1991, the Connecticut Superior Court entered a judgment of strict foreclosure. On October 28, 1991, the Debtor's law day for redemption, the Debtor filed a pro se petition for relief under Chapter 11 of the Bankruptcy Code. Pursuant to this action, the Bankruptcy Court approved the Debtor's fourth amended disclosure statement. After a hearing, the Bankruptcy Court denied confirmation of the Debtor's second amended plan of reorganization (the "Plan"), and the Debtor now appeals this Order.

II. Standard of Review

28 U.S.C. § 158(a) vests the district court with jurisdiction to hear appeals of final bankruptcy orders. In exercising this appellate jurisdiction, the court reviews the

Bankruptcy Court's conclusions of law de novo, and its findings of fact under the clearly erroneous standard. *See, e.g., In re Ionosphere Clubs, Inc.*, 922 F.2d 984, 988-89 (2d Cir. 1990), *cert. denied*, ___ U.S. ___, 112 S.Ct. 50, 116 L.Ed.2d 28 (1991); *Travelers Insur. Co. v. Bryson Properties* (*In re Bryson Properties*), 961 F.2d 496, 499 (4th Cir. 1992), *cert. denied*, ___ U.S. ___, 113 S.Ct. 191, 121 L.Ed.2d 134 (1992).

III. Discussion

A. Overview of Applicable Bankruptcy Provisions

To retain control over property under Chapter 11, a debtor must propose a plan of reorganization that is confirmed by a bankruptcy court. A reorganization plan must separate different creditors' interests into classes of interest. Only creditors with similar claims may be classified together. 11 U.S.C. § 1122(a). This ensures that similar interests are accorded similar priority in the reorganization scheme. If the interests represented by a

class are "altered" by the reorganization plan, the class is considered to be "impaired" under the plan. 11 U.S.C. § 1124(a).

The code provides that a reorganization plan may not be confirmed unless all impaired classes approve of the proposed plan. 11 U.S.C. § 1129(a)(7). A class approves a plan if more than one-half of the holders representing at least two-thirds of the interests in the class favor the plan. 11 U.S.C. § 1126(c). "Nonimpaired" classes, those creditors whose claims are unaltered, are presumed to approve of the reorganization plan. 11 U.S.C. § 1126(f).

Where all impaired classes have not approved of a plan, § 1129 provides that a plan may still be confirmed if "at least one impaired class approves the plan . . . and the debtor fulfills the cramdown requirements of § 1129(b)." *Phoenix Mutual Life Insur. v. Greystone III Joint Venture* (*In re Greystone III*), 948 F.2d 134, 138 (5th Cir. 1991), *cert. denied*, ___ U.S. ___, 113 S.Ct. 72, 121 L.Ed.2d 37

(1992). This procedure is termed "cramdown" because it enables a debtor to force the plan on dissenting classes so long as one impaired class approves and the plan is fair and equitable to the impaired classes. 11 U.S.C. § 1129(a)(10), (b)(1).

The Bankruptcy Code provides that an undersecured creditor, such as the FDIC, may treat its claim in two ways. First, under 11 U.S.C. § 506(a), an undersecured creditor may bifurcate its claim into two claims: a secured claim to the extent of the value of the collateral, and an unsecured claim for the remainder of the debt, which is the undersecured creditor's "deficiency claim." Alternatively, the creditor may elect to have its total claim treated as one secured claim under 11 U.S.C. § 1111(b)(2).

B. The Present Appeal

The Debtor's Plan included two separate classes of unsecured claims: one represented the FDIC deficiency claim and the other represented the unsecured trade interests,

a significantly smaller group of interests. In addition, the Debtor characterized all of the classes as impaired. On appeal, the Debtor contends that the Bankruptcy Court erred in ruling that the separate classification of unsecured trade claims from the deficiency claim was improper, and that the Class 3 holders were not impaired under the Plan.

1. Classification

Whether it is proper to classify an undersecured creditor's deficiency claim separately from other unsecured trade claims is an issue of considerable significance to the Debtor as the proposed isolation of the FDIC's deficiency claim from the other unsecured claims is critical to the Debtor's ability to invoke the cramdown provisions of the 11 U.S.C. § 1129. If the claims are not classified separately, the FDIC could block acceptance by the class because it holds such a large percentage of the unsecured

claims.[1]

The court recognizes that the standards governing the classification of unsecured claims are not unyielding. Although 11 U.S.C. § 1122 bars the placement of disparate claims within the same class, "it does not . . . require that all substantially similar claims be placed within the same class, and it grants some flexibility in classification of unsecured claims." *In re Bryson Properties*, 961 F.2d at 502; *see also 266 Washington Assoc. v. Citibank* (*In re Washington Assoc.*), 147 B.R. 827, 830 (Bankr. E.D.N.Y. 1992); 11 U.S.C. § 1122(a). However, "the [Bankruptcy] Code was not meant to allow a debtor complete freedom to place substantially similar claims in separate classes," *John Hancock Mutual Life Insur. v. Route 37 Bus. Park Assoc.*, 987 F.2d 154, 158 (3d Cir.1993), and it is clear that there

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[1]The unsecured trade creditors' claims total approximately $5000.00, whereas the FDIC mortgage deficiency claim totals approximately $500,000.00.

are "at least some limits on separate classification of claims with similar priority." *In re Washington Assoc.*, 147 B.R. at 830. In particular, courts have held that classes may not be manipulated so as to gerrymander the voting process and circumvent the 11 U.S.C. § 1129 requirements. *See, e.g., Hancock*, 987 F.2d at 159; *In re Bryson Properties*, 961 F.2d at 502; *In re Greystone III*, 948 F.2d at 138-39; *In re U.S. Truck Co.*, 800 F.2d 581, 586 (6th Cir. 1986).

In *Greystone III*, for example, the Fifth Circuit found that while it could not "conclude categorically that § 1122(a) prohibits the formation of different classes from similar types of claims . . . ," *id.* at 138, such classification "may only be undertaken for reasons independent of the debtor's motivation to secure the vote of an impaired, assenting class of claims." *Id.* at 139.[2]

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[2]The Debtor's reliance on *Triple R Holdings*, 134 B.R. 382 (Bankr. N.D. Cal. 1991) in opposition to the Fifth Circuit's analysis, (*see* Appellant's Brief at 24), is inappropriate as the case was reversed and is thus of little

The Fifth Circuit also noted that this classification issue requires two standards of appellate review. The similarity of claims and propriety of classification are legal issues that are reviewed by the court *de novo*. *See also Lumber Exch. Bldg. Ltd. Partnership v. Mutual Life Insur. Co.* (*In re Lumber Exch.*), 968 F.2d 647 (8th Cir.1992). Yet whether legitimate business reasons justify the separate classification of claims is a question of fact reviewed under the clearly erroneous standard. *See In re Greystone III*, 948 F.2d at 140 n.5, 141 n.7.

Applying these principles, the Debtor is correct that the separation of an undersecured creditor's deficiency claim from other unsecured claims is not impermissible *per se*. However, such a classification will only be upheld where there is a valid and compelling reason for the separation.

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precedential value. *See Triple R Holdings*, 145 B.R. 57 (Bankr. N.D. Cal. 1992) (*reversing Triple R Holdings*, 134 B.R. 382).

See, e.g., In re Lumber Exch., 968 F.2d at 650; *In re Bryson Properties*, 961 F.2d at 502; *In re Austin Ocala Ltd.*, 152 B.R. 773 (Bankr. M.D. Fla. 1993); *In re Roswell-Hannover Joint Venture*, 149 B.R. 1014, 1018 (Bankr. N.D. Ga. 1992). Accordingly, the court now turns to the Debtor's alleged reasons for the isolation of the deficiency claim from the unsecured trade claims.

The Debtor first argues that separate classification is justified because the claims are not substantially similar. Specifically, the Debtor contends that the fact that the FDIC could elect to treat its whole claim as secured under s 1111(b)(2) distinguishes the FDIC's claim from the other unsecured claims. However, this argument is wholly inconsistent with "the [Bankruptcy] Code's elimination of any legal distinction between the nonrecourse deficiency claims and other unsecured claims." *In re Washington Assoc.*, 147 B.R. at 831; *accord In re Greystone III*, 948 F.2d at 139 ("the Code has eliminated the legal distinction

between non-recourse deficiency claims and other unsecured claims."); *In re Cantonwood Assoc.*, 138 B.R. 648, 657 (Bankr. D. Mass. 1992) (holding that the right to make an election under § 1111(b) does not warrant separate classification); *cf. In re 500 Fifth Ave. Assoc.*, 148 B.R. 1010, 1021 (Bankr. S.D.N.Y. 1993) ("The distinction between recourse and nonrecourse claims . . . is irrelevant within the realm of chapter 11."). Indeed, how the FDIC's deficiency claim and the trade creditors' claims achieved their status, and whether the FDIC could have elected a different status, "does not alter their current [and common] legal character and thus does not warrant separate classification." *In re Lumber Exch.*, 968 F.2d at 649.

Furthermore, the Debtor's argument that separate classification is necessary to prevent the FDIC from dominating the unsecured class and barring the Debtor from access to the § 1129 cramdown provisions is equally unavailing. Generally, courts have rejected the argument

that the size or amount of a deficiency claim justifies separate classification. *See, e.g., In re Lumber Exch.*, 968 F.2d at 649-50; *In re Roswell-Hannover*, 149 B.R. at 1020. The court is well aware that an undersecured creditor with a large deficiency claim may threaten a debtor's ability to satisfy the § 1129 cramdown requirements. Yet this is the undersecured creditor's prerogative, and not a basis for segregation. *See In re 500 Fifth Ave. Assoc.*, 148 B.R. at 1021 ("the purpose of the section 1111(b) election is to allow the undersecured creditor a right to potentially dominate the vote within the unsecured class."). Indeed, to hold otherwise would vitiate the undersecured creditor's right to elect recourse status under 28 U.S.C. § 1111(b) and vote within the unsecured class. *See In re Lumber Exch.*, 968 F.2d at 649-50; *In re Greystone III*, 948 F.2d at 140; *In re 500 Fifth Ave. Assoc.*, 148 B.R. at 1020-21.

Finally, the Debtor argues that there are sound business reasons for the separate classification but that the

Bankruptcy Court did not entertain evidence in support of these alleged justifications. The Debtor correctly asserts that whether valid business reasons justify the separate classification of claims requires a factual inquiry. *See In re Greystone III*, 948 F.2d 141 n.7. Here, however, the Bankruptcy Court acknowledged, and rejected, the Debtor's purported business reasons for the classification. (*See* Order at 8- 10.) Although the Bankruptcy Court's inquiry would have been clearer had the Bankruptcy Court set forth the facts upon which it premised its finding, the court lacks any basis to dismiss the Bankruptcy Court's finding as clear error.[3]

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[3]The court is troubled by the Debtor's assertion that it was precluded from presenting evidence to the Bankruptcy Court in support of its business reasons for classification. At the oral argument on this appeal, this court specifically asked the Debtor's counsel what evidence it would present in support of the alleged business justifications--in essence, what evidence it was precluded from offering previously. The Debtor's counsel did not respond directly to this question, but rather, relied on the fact that, unlike the unsecured classes in Greystone III, each proposed class of unsecured claims was treated differently under the Debtor's

Thus, in the absence of a valid justification for the isolation of the FDIC deficiency claim, the court cannot find, as it must to uphold the scheme, that each proposed class represents "a voting interest that is sufficiently distinct and weighty to merit a separate voice in the decision whether the proposed reorganization should proceed." *Hancock*, 987 F.2d at 159. Rather, the court agrees with the Bankruptcy Court that the only reason for the Debtor to segregate the substantially similar unsecured claims is "to fabricate an accepting class under 11 U.S.C. § 1129(a)(10) in order to effectuate a cramdown." *In re Washington Assoc.*, 147 B.R. at 832. Therefore, the Debtor's proposed

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Plan. While this difference in treatment may be consistent with the Debtor's argument that business reasons justify the separate classification, it is not itself evidence of the purported business reasons. Moreover, even if the difference in treatment were apposite to the classification analysis, this is a matter that was clearly before the Bankruptcy Court. Therefore, the court agrees with the FDIC that the Bankruptcy Court adequately entertained the Debtor's asserted business reasons.

classification scheme is impermissible and the Bankruptcy Court's decision is affirmed. *See id.* (affirming bankruptcy court because only possible reason was impermissible); *In re Lumber Exch.*, 968 F.2d at 650 (affirming bankruptcy court because classification was a "thinly veiled attempt to manipulate the vote. . . .").

2. Impaired Class

The Debtor also challenges the Bankruptcy Court's finding that the Plan's Class 3 was not an "impaired" class. The Plan provided that Class 3 holders, tenants with security deposits, would receive a higher interest rate on their security deposits (8%) than the statutory rate (5.25%), and the Debtor described this class as an impaired assenting class. The Bankruptcy Court found that Class 3 was not "impaired" under the Plan because their interests were not affected by the Plan.

The Debtor argues that the Bankruptcy Court erred because the interests of a class need only be altered, not

harmed, to be "impaired" under the code. Thus, the Debtor contends that because Class 3 would receive a higher interest rate, their interests are sufficiently altered to be deemed impaired under the code.

The Debtor's position is largely without merit. The Debtor is correct that the value of a claim is not determinative of whether the claim is "impaired" within the meaning of § 1124. *See In re Barrington*, 15 B.R. 952, 962 (Bankr. D. Utah 1981). Rather, the emphasis under s 1124 is on rights, not values: § 1124 provides that a class is impaired under a plan unless "the plan leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder. . . ." 11 U.S.C. § 1124(1); *see also In re Barrington*, 15 B.R. at 962-63 & n.23. Therefore, a class is impaired where rights to the claims are altered, even if such alteration enhances or has no impact on the value of the claims. *Id.*

In a flawed syllogistic attempt, the Debtor argues that

because a class may be impaired even where the value of the claim is enhanced, then where the value of a claim is enhanced, the class is impaired. Yet this conclusion is neither supported by law nor logic. First, as the Bankruptcy Court noted, "if the [D]ebtor were correct, . . . any time a plan proponent needed an impaired class for a favorable vote, the debtor would simply add $1.00 to such class members' claims -- a transparent and unacceptable stratagem." (Order at 7.) Moreover, the fact that the value of a claim is enhanced by a plan has no bearing on whether the class of claims is impaired, absent a finding that the rights of the class are altered as well. See 11 U.S.C. § 1124(1). Here, the Debtor does not argue that the rights of the Class 3 members were altered, nor does the record indicate any such alteration. Thus, the Bankruptcy Court properly found that Class 3 was not impaired under the Plan.

Conclusion

Based on the foregoing, the Bankruptcy Court's Order denying confirmation of the Plan is **AFFIRMED**.

SO ORDERED.

UNITED STATES COURT OF APPEALS
FOR THE
SECOND CIRCUIT

IN RE: BOSTON POST ROAD LIMITED PARTNERSHIP,
Debtor,

BOSTON POST ROAD LIMITED PARTNERSHIP,
Plaintiff-Appellant,

v. Docket No. 93-5082

FEDERAL DEPOSIT INSURANCE CORPORATION,
Defendants-Appellee,

EVERGREEN LANDSCAPE; BOYER REALTY MGMT; FLANAGAN ASSOC. APPRAISERS; TINNERELLO RUBBISH REMOVAL; GOTTESDIENER ACCOUNTING; and WATER POLLUTION CONTROL, TOWN OF WATERFORD,
Creditors,

HONOR S. HEATH,
Trustee.

MEMORANDUM OF DECISION

Raymond L. Baribeault, Jr., New London, CT (S. Joel Suisman, Andrew J. Brand, Suisman, Shapiro, Wool, Brennan & Gray, of counsel), for plaintiff- appellant.

Walter E. Paulekas, Hartford, CT (Levin & D'Agostino, of counsel), for defendant-appellee.

Before: KEARSE and LEVAL, Circuit Judges and POLLACK, District Judge.*

MILTON POLLACK, Senior District Judge:

Debtor seeks confirmation of a Plan of Reorganization filed under Chapter 11 of the Bankruptcy Code. The Bankruptcy Court denied confirmation, holding that the Plan impermissibly (i) separately classified similar claims solely to create an impaired assenting class; and (ii) classified as "impaired" a class of residential security depositors whose interests were in fact benefitted by the Plan. The District Court affirmed the Bankruptcy Court's rulings on both issues. Debtor challenges both holdings.

BACKGROUND

Plaintiff-Appellant, Boston Post Road Limited Partnership ("BPR"), is a limited partnership formed pursuant to the Connecticut Uniform Limited Partnership

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*The Honorable Milton Pollack, Senior United States District Judge for the Southern District of New York, sitting by designation.

Act, Conn.Gen.Stat. §§ 34-9 to -82 (1993), consisting of a single individual general partner, George Boyer, and a single limited partner, George Myers. BPR was formed in 1984 to acquire and manage a residential and office complex located in Waterford, Connecticut. In March of 1988, BPR mortgaged the complex to Connecticut Bank and Trust Company ("the Bank") to secure a loan of approximately $1.6 million. BPR thereafter defaulted on the mortgage payments, and on July 20, 1990, the Bank instituted a mortgage foreclosure action in Connecticut state court. In January 1991, the Bank became insolvent, its assets were seized by the U.S. Comptroller of Currency, and the Federal Deposit Insurance Corporation ("FDIC") became the holder of BPR's mortgage.

The FDIC continued to pursue foreclosure of the mortgaged property and on August 1, 1991, the Connecticut Superior Court entered a judgment of strict foreclosure against BPR and set October 28, 1991 as BPR's last day for

redemption. On that date, BPR filed a voluntary pro se petition for relief under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Connecticut, thereby staying foreclosure. Approximately six months later, on March 16, 1992, the FDIC filed its proof of claim in BPR's bankruptcy.

On June 18, 1992, BPR filed its Second Amended Plan of Reorganization (the "Plan") in the Bankruptcy Court. The Plan proposed the following seven classes of creditors: Class 1--unsecured claims of residential tenants to security deposits entitled to priority under Section 507(a)(7) of the Bankruptcy Code; Class 2--secured claims held by creditors with liens and/or security interests on or in the real estate asset of the debtor (i.e., the secured portion of the FDIC's mortgage); Class 3--secured interests of residential tenants whose security deposits are being held by the Debtor in interest-bearing bank accounts; Class 4--unsecured claims of trade creditors; Class 5--unsecured deficiency claims of

creditors who have some security for their debt but not enough to cover the full amount owed (i.e., the unsecured portion of the FDIC's mortgage); Class 6--interests of the limited partner; and Class 7--interests of the general partner. In relevant part, the Plan proposed to pay the FDIC's secured claim (Class 2), estimated at $1.445 million, over a fifteen-year term, utilizing negative amortization with a balloon payment at the end of the fifteenth year following confirmation of the Plan; to pay the trade creditors' unsecured claims (Class 4), totalling approximately $5000, over a six-year term without interest; to pay the FDIC's unsecured mortgage deficiency claim (Class 5), estimated at $500,000, without interest following the earlier of a sale of the property or the fifteenth year following Plan confirmation;[1] and to pay the residential security deposit

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[1]During the hearing on approval of the debtor's disclosure statement, the FDIC chose to have the deficiency (excess of debt over the value of the property) treated as a separate unsecured claim. See 11 U.S.C. s 1111(b)(2).

holders (Class 3) a rate of interest on their residential security deposits higher than that statutorily mandated. In essence, the Plan was fashioned to permit a possible "cramdown" under 11 U.S.C. s 1129(b), over the anticipated objections of the FDIC, by far BPR's largest unsecured creditor. Ultimately, Class 1 turned out to be non- existent; Classes 2 and 5 voted to reject the Plan; and Classes 3, 4, 6 and 7 voted to accept the Plan.

On August 12, 1992, the Bankruptcy Court (Robert L. Krechevsky, Chief B.J.) held a hearing on the Plan's confirmation. At the hearing, the FDIC challenged the Plan on several grounds. In particular, it faulted the Plan for (i) segregating the Class 4 unsecured trade debts from the unsecured mortgage deficiency claim of the FDIC solely to gerrymander an impaired class which would approve the Plan; and (ii) classifying as "impaired" the Class 3 residential tenants with security deposits who would receive a higher interest rate on their security deposits than the

statutorily mandated rate.

After hearing initial arguments, the Bankruptcy Court requested briefs and thereafter rendered a decision denying confirmation of the Plan on October 2, 1992. In its decision, the Bankruptcy Court held that (i) the FDIC's unsecured claim should have been placed in the same class with other unsecured creditors; and (ii) the residential security deposits were not "impaired" within the meaning of Bankruptcy Code § 1124(1). In light of these two rulings, the Code requirements for Plan confirmation were not satisfied because the Plan failed to obtain an affirmative vote of a legitimately impaired class of non-insider creditors. The District Court affirmed on June 23, 1993, and the Debtor has appealed to this Court.

DISCUSSION

A plan of reorganization under the Bankruptcy Code may be confirmed if either of two voting requirements is met: (i) each class of impaired claims has accepted the

Plan, 11 U.S.C. § 1129(a)(8); or (ii) "at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider." 11 U.S.C. § 1129(a)(10). The latter makes available a "cramdown" procedure. If the debtor chooses to utilize the cramdown procedure (having failed to secure the vote of all the impaired classes), the plan must meet all of the statutory requirements enumerated in § 1129(b) (essentially that the plan is fair and equitable and does not discriminate unfairly against any impaired claims), in addition to the prerequisites of § 1129(a) which are imposed on every plan.

The voting structure set forth in the Bankruptcy Code for approval of a reorganization plan mandates that claims be placed in classes and that votes be counted on a class basis. Acceptance by a particular class of creditors occurs when "at least two-thirds in amount and more than one-half in number of allowed claims of such class ... have accepted

... such plan." 11 U.S.C. § 1126(c).

Cramdown of a plan of reorganization involving claims secured by real property owned by the debtor also often implicates Sections 506(a) and 1111(b) of the Bankruptcy Code. Section 506(a) provides that a claim secured by a lien on property is considered secured up to the value of such property and unsecured for the remainder. In this case, the FDIC's claim, totalling $1,945,000, is secured by the Debtor's sole asset, a residential and office complex. The value of the property, as agreed to by Debtor and the FDIC, is $1,445,000. Thus the FDIC has a secured claim in the amount of $1,445,000 and is entitled to an unsecured deficiency claim for the remaining $500,000. Under Section 1111(b)(2), a secured creditor may elect to have its entire mortgage claim treated as secured notwithstanding Section 506(a), thereby waiving its entitlement to an unsecured deficiency claim and increasing the amount of its secured claim. Here, however, the FDIC

did not make such an election and the time to do so has expired.

In a typical single asset real estate case such as this, the mortgagee creditor often objects to the proposed plan, thereby requiring the debtor to seek cramdown of the Plan over the mortgagee creditor's objection. Here the Debtor took two approaches in an attempt to obtain a consenting class of "impaired" creditors. First, Debtor classified the FDIC's unsecured mortgage deficiency claim of $500,000 separately from unsecured trade claims, which total only $5,000. If the deficiency claim were classified together with the other unsecured claims, the FDIC's vote against the Plan would preclude acceptance by that class. This is so because the amount of the FDIC's deficiency claim is one hundred times the amount of all other unsecured claims, making it impossible for Debtor to obtain the affirmative vote of two-thirds in amount of such class as required by Section 1126(c) of the Bankruptcy Code. Debtor's second approach

to obtaining a consenting class of "impaired" creditors was to create a purportedly impaired class of residential tenants who placed security deposits with Debtor (Class 3). The Plan provided that holders of such claims would receive interest on their security deposits at a rate of 8% rather than the 5 1/4 % mandated by Connecticut state law. Debtor asserted that this "enhancement" of that class' claims constituted "impairment" within the meaning of Section 1124.

Debtor contended that the approval of each of classes 3 and 4 satisfied the requirement of consent of an impaired class. (The consent of classes 6 and 7, the general and limited partners, could not be counted because these were insider classes.) Both the Bankruptcy Court and the District Court held (i) classifying the FDIC's unsecured mortgage deficiency claim separately from the unsecured claims of trade creditors solely to create an assenting allegedly impaired class was impermissible; and (ii) the class of

claims comprising residential tenants with security deposits was not properly classified as impaired, because the value of such claims was enhanced--not impaired--under Debtor's Plan. These rulings precluded Debtor from obtaining acceptance of its Plan by an impaired class of claims, and thereby precluded cramdown. Debtor challenges both holdings on appeal.

A. Separate classification of the several unsecured claims was without a legitimate reason.

Section 1122 of the Bankruptcy Code generally governs classification of claims. Section 1122 provides: § 1122. Classification of claims or interests. (a) Except as provided in subsection (b) of this section, a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class. (b) A plan may designate a separate class of claims consisting only of every unsecured claim that is less than or reduced to an amount that the court approves

as reasonable and necessary for administrative convenience. 11 U.S.C. § 1122 (1993). While the section bars aggregating dissimilar claims in the same class, it does not explicitly address whether similar claims must be placed in the same class. This issue of the permissibility of separate classification of similar types of claims is one that has yet to be addressed by the Second Circuit, and it remains a "hot topic" both among practitioners and in the academic community. *See* PETER E. MELTZER, *Disenfranchising the Dissenting Creditor Through Artificial Classification or Artificial Impairment*, 66 Am. Bankr. L.J. 281 (1992).

In addressing this question, the Bankruptcy and District Courts in the instant action were guided by the holdings of several other circuits, in decisions cited infra, that similar claims could not be placed in different classes solely to gerrymander a class that will assent to the plan. *See In re Boston Post Road Ltd. Partnership*, 145 B.R. 745, 748 (Bankr. D. Conn. 1992) ("The courts . . . have

uniformly prohibited a debtor from classifying similar claims differently in order to gerrymander an affirmative vote in favor of a reo[illegible]ization plan."); *In re Boston Post Road Ltd. Partnership*, 154 B.R. 617, 621 (D. Conn. 1993) ("classes may not be manipulated so as to gerrymander the voting process and circumvent the § 1129 requirements"). The other circuits have generally held that separate classification of similar claims is permissible only upon proof of a legitimate reason for separate classification, and that separate classification to gerrymander an affirmative vote is impermissible. *See, e.g., Phoenix Mut. Life Ins. Co. v. Greystone III Joint Venture (In re Greystone III)*, 995 F.2d 1274, 1279 (5th Cir. 1991), cert. denied, __ U.S. __, 113 S.Ct. 72, 121 L.Ed.2d 37 (1992) ("[T]hou shalt not classify similar claims differently in order to gerrymander an affirmative vote on a reorganization plan.").

Debtor contends that the Second Circuit should decline to follow the leads of the other circuits. It urges

that Section 1122 be interpreted to permit far more liberal separate classification of similar claims. Debtor attempts to support its contentions with reference to recent judicial interpretations of Section 1122, legislative intent, and policy considerations.

Debtor first cites two recent opinions by bankruptcy judges holding that separate classification of similar claims is in fact mandated. *See In re D & W Realty Corp.*, 156 B.R. 140, 141 & n.3 (Bankr. S.D.N.Y. 1993) (holding that "separate classification is not only appropriate, it is in fact mandated by the Bankruptcy Code and Rules," but acknowledging that it "has not found [this opinion] articulated anywhere else"), *rev'd*, 165 B.R. 127 (S.D.N.Y. Feb. 22, 1994); *In re SM 104, Ltd.*, 160 B.R. 202, 218-19 (Bankr. S.D. Fla. 1993) (holding that unsecured deficiency claims created by § 1111(b) are not substantially similar to other unsecured claims, while asserting that the "circuit courts and the majority of district and bankruptcy courts

have missed the forests for the trees").

Debtor then notes that the wording of Section 1122 does not require that all unsecured claims be classified together, but merely states that only claims that are substantially similar may be placed together. Debtor contends that this wording, especially when compared with the less flexible wording of the Bankruptcy Act of 1898, reflects Congress' intent to dispense with the requirement that similar claims be classified together.

Finally, Debtor contends that prohibiting separate classification effectively bars the debtor in single-asset cases from utilizing the cramdown provisions of the Code. In single-asset bankruptcy cases, the creditor-mortgagee usually has an unsecured deficiency claim, which, if placed in the class containing other unsecured claims (usually trade debt), will often overwhelm the class. Consequently, the mortgagee will control the vote of the class and the debtor will be unable to present an impaired class to approve the

plan. Debtor suggests that such an outcome creates a "conflict of interest": the mortgage creditor will vote its deficiency claim primarily to protect its interests as a secured creditor, whereas only those creditors who have truly unsecured claims should be the spokespeople of the unsecured class.

Debtor's arguments in support of its suggested interpretation of § 1122 are unavailing. First, the ruling in *In re D & W Realty Corp.*, 156 B.R. 140 (Bankr. S.D.N.Y. 1993) was reversed on appeal. *In re D & W Realty Corp.*, 165 B.R. 127 (S.D.N.Y. February 22, 1994). The ruling in *In re SM 104, Ltd.*, 160 B.R. 202 (Bankr. S.D. Fla. 1993), runs counter to the overwhelming weight of judicial authority. All the circuit courts that have heretofore visited the question of when similar claims may be classified separately have held that similar claims may not be separately classified solely to engineer an assenting impaired class: [I]f 1122(a) permits classification of "substantially

similar" claims in different classes, such classification may only be undertaken for reasons independent of the debtor's motivation to secure the vote of an impaired, assenting class of claims. *Greystone III*, 995 F.2d 1274, 1279 (5th Cir. 1991), *cert. denied*, __ U.S. __, 113 S.Ct. 72, 121 L.Ed.2d 37 (1992); [A]lthough separate classification of similar claims may not be prohibited, it "may only be undertaken for reasons independent of the debtor's motivation to secure the vote of an impaired, assenting class of claims." *Travelers Ins. Co. v. Bryson Properties, XVIII (In re Bryson Properties, XVIII)*, 961 F.2d 496, 502 (4th Cir.) (*quoting Greystone III*, 995 F.2d at 1279), *cert. denied*, __ U.S. __, 113 S.Ct. 191, 121 L.Ed.2d 134 (1992); [I]f the classifications are designed to manipulate class voting . . ., the plan cannot be confirmed. *Olympia & York Florida Equity Corp. v. Bank of New York* (*In re Holywell Corp.*), 913 F.2d 873, 880 (11th Cir. 1990); The debtor's discretion to place similar claims in different classes is not unlimited,

however. Classifications designed to manipulate class voting must be carefully scrutinized. There is potential for abuse when the debtor has the power to classify creditors in a manner to assure that at least one class of impaired creditors will vote for the plan, thereby making it eligible for the cram down provisions. *Hanson v. First Bank of South Dakota, N.A.*, 828 F.2d 1310, 1313 (8th Cir.1987); Unless there is some requirement of keeping similar claims together, nothing would stand in the way of a debtor seeking out a few impaired creditors (or even one such creditor) who will vote for the plan and placing them in their own class. *Teamsters Nat'l Freight Industry Negotiating Comm. v. U.S. Truck Co.* (*In re U.S. Truck Co.*), 800 F.2d 581, 586 (6th Cir.1986). Indeed, some courts have gone even further, holding that a plan must classify all substantially similar claims together, regardless of the debtor's intent. *See Granada Wines, Inc. v. New England Teamsters and Trucking Indus. Pension Fund*, 748

F.2d 42, 46 (1st Cir. 1984).

The preeminent case on the question is *Greystone III*, a case whose facts are quite similar to those in the instant case before the court. In *Greystone III*, the Court of Appeals for the Fifth Circuit observed that although similar claims may be placed in different classes, a wholly permissive reading of the statute would render subsection (b) of § 1122, which specifically allows separate classification of small claims, superfluous. In widely quoted language, the Fifth Circuit concluded: [There is] one clear rule that emerges from otherwise muddled caselaw on § 1122 claims classification: thou shalt not classify similar claims differently in order to gerrymander an affirmative vote on a reorganization plan. *Greystone III*, 995 F.2d at 1279.

Furthermore, contrary to Debtor's position, several courts have concluded that an analysis of legislative history in fact sheds little light onto the meaning of Section 1122.

See U.S. Truck, 800 F.2d at 585-86 (concluding, after careful analysis of the classification sections of the former Bankruptcy Act and legislative history of Section 1122, that "Congress has sent mixed signals on the issue"); *In re Jersey City Medical Center*, 817 F.2d 1055, 1060 (3rd Cir. 1987) (noting that "the legislative history behind § 1122 is inconclusive" regarding the significance of the wording of the section). Moreover, a reading of Section 1122 in the context of the rest of the Code suggests that discretionary separate classification of similar claims would undermine the Section 1111(b) election. As explained above, Section 1111(b) of the Bankruptcy Code permits an undersecured creditor to choose whether (i) its claim should be divided into a secured claim equal to the court-determined value of the collateral and an unsecured claim for the deficiency, or (ii) its entire claim should be considered secured. The purpose of the Section 1111(b) election is to allow the undersecured creditor to weigh in its vote with the votes of

the other unsecured creditors. Allowing the unsecured trade creditors to constitute their own class would effectively nullify the option that Congress provided to undersecured creditors to vote their deficiency as unsecured debt.

Finally, approving a plan that aims to disenfranchise the overwhelmingly largest creditor through artificial classification is simply inconsistent with the principles underlying the Bankruptcy Code. A key premise of the Code is that creditors holding greater debt should have a comparably greater voice in reorganization. Thus, although Debtor protests that prohibiting it from separating the unsecured claims of the FDIC from those of its trade creditors will effectively bar single asset debtors from utilizing the Code's cramdown provisions, Debtor fails to persuade that a single-asset debtor should be able to cramdown a plan that is designed to disadvantage its overwhelmingly largest creditor. Chapter 11 is far better served by allowing those creditors with the largest

unsecured claims to have a significant degree of input and participation in the reorganization process, since they stand to gain or lose the most from the reorganization of the debtor. This Court thus holds that separate classification of unsecured claims solely to create an impaired assenting class will not be permitted; the debtor must adduce credible proof of a legitimate reason for separate classification of similar claims.

In the instant case, Debtor was unable and failed to adduce credible proof of any legitimate reason for segregating the FDIC's unsecured claim from the unsecured claims of BPR's trade creditors. Debtor's reasons for why it should have been permitted to separately classify the FDIC's unsecured claim were: (1) the FDIC's and the trade creditors' unsecured claims were created from different circumstances and arise under different Bankruptcy Code sections; and (2) BPR's future viability as a business depends on treating its trade creditors more favorably than

the FDIC. Neither is availing. The different origins of the FDIC's unsecured deficiency claim and general unsecured trade claims, claims which enjoy similar rights and privileges within the Bankruptcy Code, do not alone justify separate segregation. *See Meltzer, supra* at 299. More importantly, BPR has failed to present any evidence of a legitimate business reason for the separate classification of similarly situated unsecured creditor claimants. The trade creditors in Class 4 were few and consisted of a landscaper, property appraisers, rubbish removers, and accountants. None were essential to BPR's future. Both lower courts accordingly found an absence of a valid justification for the isolation of the FDIC deficiency claim. No evidence to the contrary was adduced.

B. The residential security holders are not a class entitled to vote on the Plan

Debtor classified the residential tenants whose security deposits it was holding as a separate and "impaired"

class for the purposes of a cramdown under § 1129(a). In fact those interests were not harmed at all by the Plan, but are better off under the Plan. Under Connecticut law, residential security holders are entitled to interest on their security deposits at a rate of 5 1/4 %. Conn.Gen.Stat. § 47a-21 (1993). Under the proposed Plan, the interest payable on security deposits held by the landlord was increased beyond the statutory rate to 8%.

Debtor urges that the word "impaired" in § 1124 be interpreted merely as "altered" or "changed" and contends that the Class 3 creditors' rights were certainly altered by the Plan. In support of its interpretation of § 1124, Debtor points first to the language of the statute, legislative history, and a recent Ninth Circuit opinion, *In re L & J Anaheim Assoc.*, 995 F.2d 940 (9th Cir. 1993), which allegedly adopted Debtor's interpretation of Section 1124.

This Court need not even reach the issue of whether an "altered" claim may qualify as "impaired." In this case,

the Class 3 tenant security depositors could not constitute a voting class of creditors for purposes of effecting cramdown. Any claim for return of tenant security deposits would arise from the lease between the debtor and the tenant. Under the Bankruptcy Code, unexpired leases must be assumed or rejected by the Debtor. 11 U.S.C. § 365. When, as in the instant case, the Debtor does neither, the leases continue in effect and the lessees have no provable claim against the bankruptcy estate. *Greystone III*, 995 F.2d at 1281. The obligations assumed by the debtor under the continued leases constitute post-petition administrative claims. *See* 11 U.S.C. § 503(b)(1)(A). Such administrative claims are defined as priority claims under 11 U.S.C. § 507(a)(1), and must be paid in full in cash pursuant to 11 U.S.C. § 1129(a)(9)(A); their holders are not entitled to vote on a plan of reorganization. As the Fifth Circuit held in *Greystone III*: A debtor in Chapter 11 must either assume or reject its leases with third parties. 11 U.S.C. § 365. If

the debtor does neither, the leases continue in effect and the lessees have no provable claim against the bankruptcy estate. *See Matter of Whitcomb & Keller Mortgage Co.*, 715 F.2d 375, 378-79 (7th Cir. 1983); *In re Cochise College Park, Inc.*, 703 F.2d 1339, 1352 (9th Cir.1983). Under the Code, only creditors are entitled to vote on a plan of reorganization. *See* 11 U.S.C. § 1126(c). A party to a lease is considered a "creditor" who is allowed to vote, 11 U.S.C. § 1126(c), only when the party has a claim against the estate that arises from rejection of a lease. *In re Perdido Motel Group, Inc.*, 101 B.R. 289, 293-94 (Bankr. N.D. Ala. 1989). If, however, the debtor expressly assumes a lease, the lessee has no "claim" against the debtor under § 1126(a). *See* 11 U.S.C. §§ 365(g), 502(g). The rights created by assumption of the lease constitute a post-petition administrative claim under section 503(b)(1)(A) of the Code. *LJC Corp. v. Boyle*, 768 F.2d 1489, 1494 n.6 (D.C. Cir. 1985). The holder of such a claim is not entitled to vote on

a plan of reorganization. 11 U.S.C. § 1126(a); *In re Distrigas Corp.*, 66 B.R. 382, 385-86 (Bankr. D. Mass. 1986). *Greystone III*, 995 F.2d at 1281. *See also In re Cantonwood Assocs. Ltd. Partnership*, 138 B.R. 648, 656 (Bankr. D. Mass. 1992) (where Debtor neither assumes nor rejects leases, tenants' claims are post-petition administrative claims). Thus the Class 3 creditors' approval of the Plan was of no effect because its members were not entitled to vote on the Plan.

CONCLUSION

To summarize: Debtor's Plan of Reorganization was properly denied confirmation for lack of the assent of an impaired non-insider class of creditors. The unsecured trade creditors do not qualify as such a class; they were segregated without any demonstrated legitimate reason from like unsecured creditors, who rejected the Plan and whose claims predominated in amount over those of the trade creditors. Nor do residential security deposit holders qualify

as such a class; as holders of administrative claims, they were not entitled to vote on the Plan of Reorganization.

Affirmed.

In the Matter of WOODBROOK ASSOCIATES,
Debtor-Appellant.
No. 92-4014.
United States Court of Appeals,
Seventh Circuit.
Argued Sept. 17, 1993.
Decided March 18, 1994.
Rehearing Denied May 12, 1994.

19 F.3d 312, 62 U.S.L.W. 2622, 30 Collier Bankr. Cas. 2d 551, Bankr. L. Rep. ¶ 75,780

Undersecured creditor moved to dismiss debtor single-asset partnership's Chapter 11 case. The Bankruptcy Court, granted the motion, and debtor appealed. The United States District Court for the Southern District of Indiana, S. Hugh Dillin, J., affirmed, and debtor appealed. The Court of Appeals, Zagel, District Judge, sitting by designation, held that: (1) dismissal was not premature; (2) separate classification of unsecured deficiency claim is required if debtor is fully encumbered single-asset partnership; (3) proposed capital contribution did not satisfy new value exception to absolute priority rule; (4) plan could not be confirmed over creditor's objection; and (5) debtor was not

entitled to opportunity to amend plan.

Affirmed.

Jeffrey L. Hunter, Asst. U.S. Atty. (argued), Indianapolis, IN, for appellee.

Thomas D. Titsworth, John M. Rogers (argued), Bamberger & Feibleman, Indianapolis, IN, for debtor-appellant.

Before POSNER, Chief Judge, CUMMINGS, Circuit Judge, and ZAGEL, District Judge.*

ZAGEL, District Judge.

Woodbrook Associates ("Woodbrook"), is an Indiana real estate limited partnership whose sole asset is the Woodbrook Apartments constructed in 1980 in Indianapolis. The apartment complex was primarily funded by a first mortgage loan of $5,559,700.00, at 7.5%, insured by the United States Department of Housing and Urban Development (HUD). Woodbrook Apartments failed to generate the expected income levels, the partnership

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*The Honorable James B. Zagel, District Judge for the Northern District of Illinois, is sitting by designation.

defaulted, and the original mortgage holder assigned the mortgage in 1988 to HUD.

In July 1990, HUD advertised Woodbrook Apartments for sale by private bid on September 5, 1990, stating that it would not bid over $3.4 million. On August 21, 1990, Woodbrook filed a voluntary Chapter 11 petition, and the advertised foreclosure sale was stayed.

Deci-Ma Management Corporation ("Deci-Ma Management") continued to serve as project manager of the apartments during the bankruptcy, as it had since the inception of the project.[1] Woodbrook then ceased paying net operating revenues to HUD, which had been less than the stipulated debt service.

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[1]The record is unclear as to how Deci-Ma Corporation served Woodbrook and its relationship to Deci-Ma Management. The district court found (and we agree) that Deci-Ma Corporation appears to be affiliated with Deci-Ma Management. Deci-Ma Corporation, however, has an unsecured claim of about $30,000, which presumably constitutes some sort of trade debt separate from the management fees owed to Deci-Ma Management.

Woodbrook filed a proposed Plan of Reorganization on April 19, 1991, eight months after the bankruptcy petition, and a substantially similar amended plan on June 14, 1991, by which time Woodbrook had possession of a net operating surplus of about $225,000 which it would otherwise have paid to HUD. The plan creates eight classes of claims and interests. Classes 1 and 2, as is typical, are reserved for expenses incurred by professionals and other administrative costs. Payments to creditors are structured as follows: HUD's secured claim (Class 3), valued at $3.6 million, is to be paid over 30 years at the mortgage interest rate of 7.5%; HUD will also be paid 5% of its unsecured deficiency claim (Class 4), plus all funds on hand at confirmation excluding $100,000 (reserved for repairs, working capital and bankruptcy fees, and expenses); Deci-Ma Management's unsecured claim (Class 5) will be paid in full over one year; Deci-Ma Corporation's unsecured claim (Class 6) will be paid monthly from any

remaining cash flow from the debtor's operations until paid in full; other unsecured creditors (Class 7) will be paid in full 30 days after confirmation; and the general and limited partners of the debtor (Class 8) will retain their ownership interests in return for new capital contributions. The plan also provides in Article IV that, in the event the Bankruptcy Court determines the plan cannot be confirmed as a consequence of the proposed retention of ownership by the general and limited partners (Class 8), their interests will be deemed cancelled and void (presumably along with their obligation to contribute new capital) and the "property of the estate" will, instead, vest in Deci-Ma Corporation (Class 6), in satisfaction of its general unsecured claim. Funding for the plan would be secured from apartment rentals and the new cash infusion by "a new corporate general partner that will be substituted for the existing general partners." This new cash contribution would be used to pay off the 5% distribution on HUD's unsecured deficiency claim, unless

Article IV was triggered. Finally, the cash on hand would be allocated first to administrative expenses, then to a $100,000 fund for roof repairs and working capital, and ultimately to HUD's unsecured claim.

The next month, before any confirmation hearing or voting on the amended plan, HUD moved to dismiss the bankruptcy case, saying that HUD would not accept Woodbrook's proposed plan or any plan not providing for full payment of its claim. At the hearing on the motion, Sam Birch, a HUD loan specialist, swore that the plan was not "fair" and said that he did not have authority to accept any plan other than one which paid HUD in full. Charles Harvey, a Woodbrook general partner, testified the project was worth $3.6 million and the occupancy rate for the complex was 95% at the time of the amended plan. He also confirmed that the "principal" of Deci-Ma Management was his brother-in-law, that Woodbrook was maintaining the property, and that Woodbrook would be able to make the

payments provided in the plan. The Disclosure Statement filed by Harvey on July 1, 1991, stated that his wife, Patricia Harvey, "owns 48% of the common capital stock of Deci-Ma Corporation which is insolvent and is a Chapter 11 debtor in bankruptcy proceedings."

The bankruptcy court found, in part, that HUD would not accept any plan which did not provide for full payment of its claim; that general partner Charles Harvey had a beneficial interest in Deci-Ma Management and Deci-Ma Corporation; that HUD objected to Woodbrook's use of the money it kept; and that the plan could not be confirmed over HUD's objection. The court ultimately dismissed the bankruptcy case for cause, concluding that: (1) the plan could not be confirmed because it unfairly discriminated among unsecured creditors and violated the absolute priority rule; (2) the plan was not feasible because it relied on the use of funds in which HUD had a lien without HUD's consent; and (3) the proposal of an unconfirmable plan

constituted an unreasonable delay and prejudiced the creditors.

Woodbrook then moved under Bankruptcy Rule 9023 to amend the findings and conclusions or, alternatively, to file an amended plan. The Rule 9023 motion said that the dismissal was unsupported by the evidence and contrary to law and that it decided issues not raised by HUD's motion. Lastly, Woodbrook asked for leave to file an amended plan providing for full payment of HUD's claim of $6,208,273.24, plus interest, under terms which it believed would quell the court's concerns, but it did not say what those terms were. The bankruptcy court denied the Rule 9023 motion and did not permit Woodbrook to file a second amended plan. The district court affirmed, holding that Woodbrook would not be able to effectuate the proposed plan because it improperly classified unsecured claims in separate classes, violated the absolute priority rule, and did not meet the new value exception.

Woodbrook now appeals the district court's order, as it may under 28 U.S.C. §§ 158 and 1291. On appeal, this Court must accept the bankruptcy court's findings of fact unless they are clearly erroneous, a tough test. *Matter of Excalibur Auto. Corp.*, 859 F.2d 454, 457, n.3 (7th Cir. 1988). Conclusions of law are reviewed *de novo*. *Id.*

DISMISSAL FOR CAUSE

A bankruptcy court has broad discretion under 11 U.S.C. § 1112(b) to dismiss a Chapter 11 case for cause. *In re Lumber Exchange Bldg. Ltd. Partnership*, 968 F.2d 647, 648 (8th Cir. 1992). Woodbrook's bankruptcy case was dismissed under § 1112(b)(2), which authorizes dismissals for the inability to effectuate a plan. A § 1112(b)(2) dismissal is proper "if the court determines that it is unreasonable to expect that a plan can be confirmed in the [C]hapter 11 case." 5 Conrad K. Cyr *et al.*, COLLIER ON BANKRUPTCY ¶ 1112.03[2][d][ii], at 1112-19-20 (15th ed. 1993).

NOTICE

Woodbrook says it did not have adequate notice of the issues considered by the bankruptcy court and so was foreclosed from either offering appropriate evidence or amending the plan. A review of the motion compels us to reject Woodbrook's assertion. HUD's motion plainly states that HUD "will not accept the Plan as filed, or any other Plan not providing for payment in full of its claim." This declaration in the context of a motion to dismiss should have alerted Woodbrook to the potential confirmation problems addressed by the courts below since the major creditor comprising an impaired class (or two) of unsecured creditors rejected the plan. Although it would have been desirable for HUD to spell out in detail all the alleged defects in the plan, its failure to do so is not fatal and neither deprived Woodbrook of adequate notice nor prejudiced Woodbrook at the hearing. This formal notice is adequate and, in fact, Woodbrook had actual notice. HUD

quotes, without contradiction, Woodbrook's memorandum in opposition to dismissal where Woodbrook said, "[T]he issue raised by the government's Motion is whether the unsecured deficiency claim of HUD must be classified in the same class with all other general unsecured creditors. If this is the case, the debtor will be unable to obtain acceptance by any unimpaired class." Woodbrook cannot reasonably claim ignorance of the issues raised in HUD's motion to dismiss.

TIMING

Nor can Woodbrook win on a claim that dismissal was premature. A Chapter 11 case can be dismissed at any time. Creditors need not wait until a debtor proposes a plan or until the debtor's exclusive right to file a plan has expired. *In re Park Ave. Partners Ltd. Partnership*, 95 B.R. 605, 609 (Bankr. E.D. Wis. 1988). Creditors, likewise, need not incur the added time and expense of a confirmation hearing on a plan they believe cannot be effectuated. *See*

Hall v. Vance, 887 F.2d 1041, 1044 (10th Cir. 1989) (case dismissed where acceptable plan was not filed within eight months of Chapter 11 petition). The very purpose of § 1112(b) is to cut short this plan and confirmation process where it is pointless. The bankruptcy court found cause to dismiss the case under 11 U.S.C. § 1112(b), and it was not required to consider alternative remedies other than conversion to Chapter 7 in the best interest of the creditors. No one here claims (or claimed below) that conversion is in the best interest of the creditors.

BURDEN OF PROOF

Woodbrook argues that the bankruptcy court erred in placing a burden of proof on Woodbrook. The sentence in the ruling on which Woodbrook relies for this argument reads: "In the instant case, debtor has not produced sufficient evidence to demonstrate that the interests of the non-HUD creditors are sufficiently unique to warrant separate classification." This sentence, however, is quoted

from the district court's opinion and does not reflect the standard of proof used by the bankruptcy court. Nor does it show that the district court applied the wrong standard of proof on review. Where a motion to dismiss for cause is opposed, the movant bears the burden of proving by a preponderance of the evidence that cause exists for dismissal of the debtor's bankruptcy case. 5 COLLIER ON BANKRUPTCY ¶ 1112.03[2][a], at 1112-16; *Colonial Daytona Ltd. Partnership v. American Sav. of Fla., F.S.B.*, 152 B.R. 996, 1002 (M.D. Fla. 1993). That HUD bears the burden of persuasion, however, does not eviscerate Woodbrook's obligation to produce evidence in opposition to a well-supported motion. Viewed sensibly in the context of the entire opinion, the quoted sentence reflects the district court's view of the sufficiency of the evidence presented at the hearing and HUD's success in persuading the courts that cause for dismissal existed based on Woodbrook's classification scheme. The district court did not err in its

placement of the burden of proof or application of standards of review.

CLASSIFICATION OF CREDITORS

Did cause exist to dismiss Woodbrook's Chapter 11 case? Woodbrook argues that separate classification of HUD's § 1111(b) unsecured deficiency claim[2] was proper because the amount and character of HUD's claim rendered it different from the unsecured claims of other creditors. HUD maintains that dismissal for cause was proper because Woodbrook engaged in "abusive" classification aimed at gerrymandering an affirmative vote. We review *de novo* the propriety of classification. *Lumber Exchange*, 968 F.2d at

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[2]A § 1111(b) unsecured deficiency claim is created in favor of an undersecured creditor in the amount of the lien in excess of the collateral's value, *i.e.*, an undersecured creditor has a secured claim up to the value of the collateral and an unsecured claim for the deficiency. 11 U.S.C. §§ 506(a), 1111(b). An undersecured creditor, however, may waive its deficiency claim and elect, under § 1111(b)(2), to have its claim treated as secured for the entire amount of the debt.

649.

Woodbrook possesses considerable, but not complete, discretion to classify claims and interests in its Chapter 11 plan of reorganization. *In re Holywell Corp.*, 913 F.2d 873, 880 (11th Cir. 1990). Some limits are necessary to offset a debtor's incentive to manipulate a classification scheme and ensure the affirmative vote of at least one impaired class, which is what the debtor needs to gain confirmation of the plan. *Id.*; *In re U.S. Truck Co., Inc.*, 800 F.2d 581, 586 (6th Cir. 1986). What these limits may be is subject to debate. Section 1122(a) says: "a plan may place a claim or interest in a particular class only if such claim or interest is substantially similar to the other claims or interest of such class." 11 U.S.C. § 1122(a).[3] Section 1122 does not

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[3]Subsection (b) provides: "A plan may designate a separate class of claims consisting only of every unsecured claim that is less than or reduced to an amount that the court approves as reasonable and necessary for administrative convenience." 11 U.S.C. § 1122(b) (1988). Woodbrook has designated such a class of unnamed unsecured creditors. However, there is no dispute regarding the propriety of

expressly forbid the separate classification of similar claims. Yet, the Fifth Circuit has coined a phrase referred to as the "one clear rule": "thou shalt not classify similar claims differently in order to gerrymander an affirmative vote on reorganization." *Matter of Greystone III Joint Venture*, 995 F.2d 1274, 1279 (5th Cir. 1991). *Greystone* condones separate classification "for reasons independent of the debtor's motivation to secure the vote of an impaired, assenting class of claims." *Id.*; *accord Lumber Exchange*, 968 F.2d at 649; *In re Johnston*, 140 B.R. 526, 529 (9th Cir. BAP 1992).

The "one clear rule" is not easy to apply since it is not about "classifying similar claims"; it is about the debtor's purpose. Similarity is not a precise relationship, and the elements by which we judge similarity or resemblance shifts from time to time in bankruptcy. Some

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Woodbrook's classification in this respect.

courts had permitted separate classification based simply on a readily perceived legal distinction between unsecured deficiency claims created by § 1111(b) and general unsecured claims. These courts noted that general unsecured claims are recourse claims cognizable under state law while § 1111(b) claims exist only within a Chapter 11 bankruptcy case and are not cognizable under state law. *See, e.g., In re Aztec Co.*, 107 B.R. 585, 587 (Bankr. M.D. Tenn. 1989). This legal distinction has been eliminated by the Code (because a § 1111(b) deficiency claim is an unsecured claim in Chapter 11), and it has been rejected as the sole basis for separate classification by a majority of circuits. 11 U.S.C. § 1111(b)(1)(A); *Greystone*, 995 F.2d at 1279; *John Hancock Mut. Life Ins. Co. v. Route 37 Business Park Assocs.*, 987 F.2d 154, 161 (3rd Cir. 1993); *Lumber Exchange*, 968 F.2d at 649. Other courts have permitted separate classification on the grounds that the vote of § 1111(b) claims "will be uniquely affected by the plan's

proposed treatment of the secured claim held by the creditor"; a § 1111(b) claimant may vote its large deficiency claim to defeat any plan, obtain relief from the automatic stay and foreclose, while the general unsecured claimant has a strong incentive to vote to accept the plan because it may receive nothing from liquidating the debtor if the automatic stay is lifted. *In re SM 104 Ltd.*, 160 B.R. 202, 218 & n.35 (Bankr. S.D. Fla. 1993) (voting incentive rationale "is highly persuasive when viewed in light of the logic underlying § 1129(a)(10) . . . [which was] intended not to give the real estate lobby a veto power, but merely to require 'some indicia of creditor support' for confirmation of a proposed Chapter 11 plan"); *Aztec*, 107 B.R. at 587.[4]

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[4]*But see Route 37*, 987 F.2d at 161-62 (rejecting voting incentive rationale because "absent bad faith or illegality . . . , the Code is not concerned with a claim holder's reason for voting one way or another . . . [and because,] undoubtedly, most claim holders vote in accordance with their overall economic interests," not simply creditor interests).

The voting incentive theory is worthy of careful study, but we need not reach the question of whether the voting incentive rationale supports the separate classification of HUD's claim.

Significant disparities do exist between the legal rights of the holder of a § 1111(b) claim and the holder of a general unsecured claim which render the two claims not substantially similar and which preclude the two from being classified together under § 1122(a). Thus, we cannot accept the proposition implicit in Greystone that separate classification of a § 1111(b) claim is nearly conclusive evidence of a debtor's intent to gerrymander an affirmative vote for confirmation. These disparities in rights stem from the most obvious difference between the two claims: a general unsecured claim exists in all chapters of the Code, while a § 1111(b) claim exists only as long as the case remains in Chapter 11 and, once converted to a Chapter 7 case, recovery is limited to its collateral. *Compare* 11

U.S.C. § 103(f) with 11 U.S.C. § 502(b)(1). This difference is amplified when the debtor is a partnership (as in this case) and the creditors face possible failure of its Chapter 11 case. Under such circumstances, the general unsecured creditors can seek equitable relief to prevent dissipation of the assets of the general partners, who upon conversion to Chapter 7, are liable for the debts of the partnership. Such equitable relief is not likely to be available to a § 1111(b) claimant, whose recovery is confined to its collateral.

This legal difference between the two claims also can lead to anomalous results when applying other sections of the Code to a class containing both § 1111(b) claimants and general unsecured claimants. First, section 1129(a)(7) requires that, for confirmation of a plan where a holder of a claim or interest in an impaired class rejects the plan, each claimant must "receive or retain . . . property of a value, as of the effective date of the plan, that is not less than the amount . . . receive[d] or retain[ed] if the debtor were

liquidated under [C]hapter 7." 11 U.S.C. § 1129(a)(7). A § 1111(b) claimant is not entitled to payment under Chapter 7. Yet, because the § 1111(b) claimant has been classified with other general unsecured creditors and because § 1123(a)(4) mandates the same treatment of all claims in the class, the § 1111(b) claimant can block confirmation unless it receives payment of an amount equal to that of the general unsecured creditors. More importantly, there are anomalies in the application of § 1111(b) itself. Section 1111(b)(a)(A)(i), which requires that a § 1111(b)(2) election be made by "the class of which such [§ 1111(b)] claim is a part," means the general unsecured creditors, included in the class, must vote on whether the § 1111(b) claimants should make the § 1111(b)(2) election. The general unsecured creditors, consequently, can block approval of the election by a majority of votes. 11 U.S.C. § 1111(b)(1)(A)(i); Fed. R. Bankr. P. 3014. Finally, general unsecured creditors, who have no lien claims, can participate in the election

process because the class comprised of the § 1111(b) claimants holds collateral that is not of inconsequential value.[5] These anomalies are all clearly set out in Judge Ginsberg's well-reasoned opinion, *In re SM 104 Ltd.*, 160 B.R. 202, 219-21 (Bankr. S.D. Fla. 1993).

The drafters of the Bankruptcy Code did not intend these results. We find that, at least where the debtor is a partnership comprised of a fully encumbered single asset, the legal rights of a § 1111(b) claimant are substantially different from those of a general unsecured claimant. Accordingly, we hold that §§ 1111(b) and 1122(a) not only permit but require separate classification of HUD's § 1111(b) unsecured deficiency claim in Class 4. Woodbrook's separate classification of HUD's § 1111(b) claim neither prevents confirmation of Woodbrook's plan

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[5]Section 1111(b)(1)(B) denies the right to make an election to "[a] class of claims" if the lien claims of the class members are of "inconsequential value." 11 U.S.C. § 1111(b)(1)(B).

nor serves as conclusive evidence in this case that Woodbrook manipulated the plan to obtain an affirmative vote. The bankruptcy court, however, found other barriers to confirmation.

ABSOLUTE PRIORITY RULE

To be confirmed under the cramdown provision of the Code, a plan must satisfy the absolute priority rule. That is, the claims or interests of a dissenting class of unsecured creditors must be fully satisfied before any junior class may retain any property under the reorganization plan. 11 U.S.C. § 1129(b)(2)(C); *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 202, 108 S.Ct. 963, 966, 99 L.Ed.2d 169 (1988); *Matter of Snyder*, 967 F.2d 1126, 1128 (7th Cir. 1992). HUD says the proposed retention of ownership interest by the partners of the debtor, without payment in full of HUD's claim, violates the rule. Woodbrook counters that the partners' infusion of new capital contributions in exchange for their ownership interests places the plan

outside the rule.

The new value precept permits old equity owners to participate in a plan, without full payment to the dissenting creditors, if they make a new contribution (1) in money or money's worth, (2) that is reasonably equivalent to the value of the new equity interests in the reorganized debtor, and (3) that is necessary for implementation of a feasible reorganization plan. *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106, 121-22, 60 S.Ct. 1, 10, 84 L.Ed. 110 (1939). Under this precept, old equity owners may purchase new equity interests in the reorganized debtor.

The new value precept, though mentioned in the Bankruptcy Commission's report to Congress, was not expressly codified in the Bankruptcy Code of 1978. Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 137, 93rd Cong., 1st Sess. pt. 2 at 241-42. Whether it survives the enactment of the new Code is the subject of much debate. The current trend is to treat

the new value precept not as an exception (as it was commonly called) but as a corollary to the absolute priority rule preserved in the 1978 Code. *See Snyder*, 967 F.2d at 1130-31. The Supreme Court has yet to endorse or condemn such an interpretation of the Code,[6] and we follow our prior decisions[7] and again reserve ruling on the viability of the new value precept until another day. We reserve ruling because, even if we assume that this precept survives, we find the record supports the lower courts' conclusion that the proposed $100,000 contribution does not satisfy the new

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[6]The Supreme Court, however, has granted certiorari in *In re Bonner Mall Partnership*, 2 F.3d 899 (9th Cir. 1993), *cert. granted*, __ U.S. __, 114 S.Ct. 681, 126 L.Ed.2d 648 (1994). After a thorough analysis of the 1978 Code, the Ninth Circuit held that the new value corollary, or "the scrutinize old equity participation rule," continues to be a "vital legal principle." *Id.* at 906-17.

[7]*In re Snyder*, 967 F.2d 1126, 1131 (7th Cir. 1992); *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, 1362 (7th Cir. 1990); *In re Stegall*, 865 F.2d 140, 142 (7th Cir. 1989).

value criteria.

The district court reasoned that a proposed new capital infusion of $100,000 could not be considered "substantial" since it constituted, at most, 3.8% of the approximately $2.6 million of total unsecured debt.[8] Simply put, "substantiality" requires that the contribution be real and necessary to the successful implementation of a feasible plan. *Snyder*, 967 F.2d at 1131; *see SM 104*, 160 B.R. at 226 n.43 (finding it difficult to believe a contribution that is real and renders the plan feasible would not qualify as "substantial"). Essentially, what the lower courts determined was that the proposed contribution, though in money, was a token cash infusion and not a fair price for the right to participate in the reorganized debtor. A token cash infusion violates the absolute priority rule

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[8]The bankruptcy court concluded that the plan violated the absolute priority rule. The district court clarified the basis of the bankruptcy court's conclusion.

because the old equity owners are receiving the opportunity to purchase the new equity interests at a bargain price "on account of" their prepetition ownership. *See Matter of Stegall*, 865 F.2d 140, 144 (7th Cir. 1989); *SM 104*, 160 B.R. at 226-27.

Whether the infusion of new capital is "substantial" is more a common sense determination than a mathematical calculation when the debtor comprises only a single real estate asset which is fully encumbered. And, as this Circuit noted in Snyder, this determination may not always hinge on a comparison of the proposed contribution to the total amount of unsecured debt. *Snyder*, 967 F.2d at 1131. A court must make an informed judgment based on the facts of each case. We cannot say in this case, "where the disparity between the contribution and the unsecured debt is so extreme," that the lower courts' finding of insubstantiality is clearly erroneous. *See Snyder*, 967 F.2d at 1131-32 (refusing to disturb the bankruptcy and district courts'

finding that the infusion of $30,000 in new capital, which was just 4.5% of the total amount due unsecured creditors, was not substantial). We agree with the courts below that the proposed token cash infusion does not constitute "new value" and violates the absolute priority rule. A Chapter 11 plan that violates the absolute priority rule cannot be confirmed over a creditor's legitimate objections. *Ahlers*, 485 U.S. at 202, 108 S.Ct. at 966 (1988).[9]

Woodbrook urges that Article IV saves the plan by voiding the partners' interests and vesting them in Deci-Ma Corporation in the event the bankruptcy court rejects the new value proposal. We disagree. The proposed "savings clause" may sound the plan's death knell. If Article IV is

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[9]Woodbrook insists that whether the amount of capital infusion is substantial is a determination that must be made at the confirmation hearing. Dismissal here was not premature. A bankruptcy court need not engage in any further analysis of substantiality where the disparity between the proposed cash infusion and unsecured debt is so extreme. *See Snyder*, 967 F.2d at 1132.

triggered, the 5% distribution to HUD is voided. The ultimate effect is to divest HUD of the 5% distribution towards its unsecured claim and vest the "property of the estate" in Deci-Ma Corporation in satisfaction of its unsecured claim. Deci-Ma Corporation's receipt of an equity interest without new cash infusion may violate the absolute priority rule. Furthermore, a fair reading of Article IV is that the new cash infusion is cancelled, and the cancellation of the new cash infusion confirms that the contribution is not necessary for the implementation of Woodbrook's plan and cannot qualify as "new value."

On the other hand, it may be that Deci-Ma Corporation's receipt of equity interests as payment of its unsecured claim does not violate the absolute priority rule since Deci-Ma Corporation is not a prepetition owner and that the new cash infusion is not cancelled but rather is to be distributed as cash on hand. But this does not help the debtor here. In any event, the operation of Article IV only

brings to light another barrier to confirmation, *i.e.*, the unfair treatment of or discrimination among unsecured creditors. 11 U.S.C. § 1129(b)(1). Clearly, the plan treats Deci-Ma Corporation and Deci-Ma Management more favorably at HUD's expense because of the connection to Harvey's wife and brother-in-law. Article IV preserves the equity interests and assets for insiders of the debtor. The meager 5% distribution, if any, on HUD's § 1111(b) unsecured deficiency claim, given the full payment of Deci-Ma Corporation's and Deci-Ma Management's unsecured claims, clearly suggests from our perspective, as it did from the perspective of the courts below, that this plan was the "three dollar bill." Such a plan, therefore, that unfairly discriminates among unsecured creditors cannot be confirmed. *See Aztec*, 107 B.R. at 588-92.

HUD'S NEGATIVE VOTE

The bankruptcy court also determined that the plan could not be confirmed over HUD's objection. Under

Woodbrook's amended plan, HUD would receive roughly 5% of its $2.6 million unsecured claim over three years, or $130,000; Deci-Ma Management would receive all of its unsecured claim within a year; and, Deci-Ma Corporation would receive Woodbrook's cash flow available after debt service until paid in full. HUD refused to accept the plan. This plan could be "crammed down" HUD's throat if at least one impaired class[10] of creditors accepted the plan, not counting the acceptance by an insider. 11 U.S.C. § 1129(a)(10).

The difficulty here is that the only other impaired classes are Class 5 (Deci- Ma Management) and Class 6 (Deci-Ma Corporation). Charles Harvey, one of the debtor's partners, has a beneficial interest in both Deci-Ma Corporation and Deci-Ma Management. Charles Harvey's

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[10]A class is impaired if there is "any alteration of a creditor's rights, no matter how minor." *In re Windsor on the River Assocs., Ltd.*, 7 F.3d 127, 130 (8th Cir. 1993).

wife owns 48% of the capital stock in Deci-Ma Corporation and the "principal" of Deci-Ma Management is Harvey's brother-in-law. The definition of "insider" under the Bankruptcy Code s 101 is "extremely broad." 5 COLLIER ON BANKRUPTCY ¶ 1129.02, at 1129-35. Where the debtor is a partnership, insiders include "relatives of a general partner in, general partner of, or person in control of the debtor." 11 U.S.C. § 101(31)(C)(ii). Any affirmative vote from Deci-Ma Corporation and Deci-Ma Management must be discounted as an insider vote. Thus, as the bankruptcy court found, confirmation cannot be achieved over HUD's objection. Dismissal of Woodbrook's Chapter 11 case, under these circumstances, was in the creditor's best interest. *See Lumber Exchange*, 968 F.2d at 650 (dismissal is in the creditor's best interest where § 1111(b) claimant can block any plan that does not pay its claim in full and debtor comprised a single real estate asset).

DENIAL OF OPPORTUNITY TO AMEND PLAN

Finally, Woodbrook insists that any defects in the plan can be cured by amendment and that its offer to submit a plan paying HUD's claim in full plus interest renders dismissal for inability to effectuate a plan improper. "Chapter 11 provides a reasonable opportunity for corporate reorganization[;] it does not guarantee reorganization nor does it permit an indefinite suspension of creditors' rights and remedies pending the unsuccessful attempts of any party to effect a reorganization of debt." *In re BGNX, Inc.*, 76 B.R. 851, 853 (Bankr. S.D. Fla. 1987) (in view of time elapsed and failure of proponents to obtain consent of United States, court converted Chapter 11 case to Chapter 7 liquidation after second proposed plan was unconfirmable). A special aspect of the practice of bankruptcy is that it functions on a fluid set of facts, *i.e.*, the plan can always be changed. And, for the most part, bankruptcy courts permit the parties to submit numerous and alternative plans. Yet, bankruptcy courts are given a great

deal of discretion to say when enough is enough.

Woodbrook was afforded an opportunity to amend its original plan. Woodbrook filed an amended plan two months after filing the original plan and ten months after filing for bankruptcy. The amended plan was substantially similar to the original plan. Essentially, Woodbrook had taken two bites at the apple and each time took a risk in formulating a plan that bordered on the fine line of unfair discrimination and feasible reorganization. The new amendment, Woodbrook's third bite at the apple, simply proposes to pay HUD's unsecured claim in full.[11] This amendment looks less like an honest effort to devise an

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[11]In the Rule 9023 motion, Woodbrook proposed to pay HUD's claim "in the amount of $6,208,273.24 at the rate of 8% per annum in level monthly payments commencing 30 days after confirmation at an amortization rate of 40 years, with the balance payable in 30 years . . . [A]ccumulated net rentals on hand, except for an amount necessary for working capital, satisfaction of expenses of administration and payment of small general claims shall be paid over to HUD for application to the principal amount of its claim."

acceptable plan and more like a death-bed conversion, particularly where the proposed amendment is vague on important details such as funding for the plan. Under the circumstances, we find that the bankruptcy court did not abuse its discretion in denying Woodbrook an opportunity to amend the plan a second time. *See Hall*, 887 F.2d at 1044-45 (bankruptcy court did not abuse discretion in dismissing Chapter 11 case under § 1112(b)(2) and in not considering remedies other than dismissal "where the debtor's failure to file an acceptable plan after a reasonable time indicated its inability to do so").

Other arguments were raised to support reversal. We have considered each of them but none is persuasive or worthy of discussion in this opinion. Furthermore, because we conclude that dismissal under § 1112(b)(2) was justified, we need not address Woodbrook's assignment of error with respect to dismissal under § 1112(b)(3).

For the foregoing reasons, the judgment of the

district court affirming the bankruptcy court's dismissal of the debtor's bankruptcy case is **AFFIRMED**.

UNITED STATES COURT OF APPEALS
FOR THE
SECOND CIRCUIT

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the 14th day of June one thousand nine hundred and ninety-four.

IN RE: BOSTON POST ROAD LIMITED PARTNERSHIP,
Debtor,

BOSTON POST ROAD LIMITED PARTNERSHIP,
Plaintiff-Appellant

v. Docket No. 93-5082

FEDERAL DEPOSIT INSURANCE CORPORATION,
Defendants-Appellee,

EVERGREEN LANDSCAPE; BOYER REALTY MGMT; FLANAGAN ASSOC. APPRAISERS; TINNERELLO RUBBISH REMOVAL; GOTTESDIENER ACCOUNTING; and WATER POLLUTION CONTROL, TOWN OF WATERFORD,

Creditors,

HONOR S. HEATH,

Trustee

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by Appellant BOSTON ROAD LIMITED PARTNERSHIP.

Upon consideration by the panel that decided the appeal, it is

Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

For the Court,
George Lange, III, Clerk

By: /s/ Carolyn Clark Campbell
Carolyn Clark Campbell
Chief Deputy Clerk

UNITED STATES COURT OF APPEALS
FOR THE
SECOND CIRCUIT

MANDATE

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the 30th day of March, one thousand nine hundred and ninety-four.

Present: HON. AMALYA L. KEARSE
HON. PIERRE N. LEVAL,
Circuit Judges.
HON. MILTON POLLACK,
District Judge*

In re: BOSTON POST ROAD LIMITED PARTNERSHIP,
Debtor,

BOSTON POST ROAD LIMITED PARTNERSHIP,
Plaintiff-Appellant,

-v.- Docket No. 93-5082

FEDERAL DEPOSIT INSURANCE CORPORATION,
Defendant-Appellee,

EVERGREEN LANDSCAPE; BOYER REALTY MGMT; FLANAGAN ASSOC. APPRAISERS; TINNERELLO RUBBISH REMOVAL; GOTTESDIENER ACCOUNTING;

and WATER POLLUTION CONTROL, Town of Waterford,

Creditors,

HONOR S. HEATH,

Trustee

ISSUED AS MANDATE 6-21-94

UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT

In re	:	CHAPTER 11
BOSTON POST	:	CASE NO.
LIMITED PARTNERSHIP	:	91-23498 (RLK)
Debtor	:	
	:	December 17, 1992

SECOND PLAN OF REORGANIZATION

Debtor in Possession submits this Second Plan of Reorganization, in conjunction with its Disclosure Statement.

Respectfully submitted,

SUISMAN, SHAPIRO, WOOL,
BRENNAN & GRAY, P.C.

By: /s/ S. Joel Suisman

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DEBTOR-IN-POSSESSION

BOSTON POST LIMITED PARTNERSHIP

SECOND PLAN OF REORGANIZATION

December 17, 1992

By:

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BOSTON POST LIMITED PARTNERSHIP
SECOND PLAN OF REORGANIZATION

ARTICLE I

Definitions

A. Defined Terms

The following terms have the following meanings (such meanings to be equally applicable to both the singular and plural forms of the terms defined) whenever used in the Plan.

1. **Additional Capital Contributions** shall mean, with respect to the Class 4 Limited Partner, or the Class 5 General Partner, additional capital contribution to the Partnership necessary and sufficient to meet all tenant improvement, deferred maintenance, and broker commission obligations and cash funds required upon confirmation under this Plan of Reorganization and as required by 11 U.S.C. Section 129(a)(9)(A), up to a total of $200,000.

2. **Administrative Claim** shall mean any claim

for any cost or expense of administration in connection with the Chapter 11 case, in accordance with Section 503 of the Bankruptcy Code, including, without limitation:

(a) The actual, necessary costs and expenses of preserving the Debtor's estate and of operating the business of the Debtor (other than such claims which, by their express terms, are not due or payable by the Effective Date);

(b) The full amount of all claims for allowances of compensation for legal or other professional services or reimbursement of costs and expenses under Sections 330 or Section 503(b) of the Code or otherwise allowed by the Bankruptcy Court;

(c) All fees and charges assessed against the Debtor's estate under Chapter 123 of Title 28, United States Code; and

(d) Expenses incurred by debtor in connection with this case, including the cost of

appraisal fees, attorney fees and expenses incurred in obtaining a confirmed plan, in such amount as the Court shall allow, shall be deemed administrative expenses pursuant to Section 503(b) of the Bankruptcy Code for the purposes of this Plan.

3. **Allowed Claim or Allowed Interest** shall mean a claim against or equity security interest in the Debtor to the extent that: (a) a proof of such claim or interest was (i) timely filed; (ii) deemed filed pursuant to Section 1111(a) of the Bankruptcy Code; and (b)(i) which is not objected to, or (ii) which is allowed (and only to the extent allowed) by an order of the Bankruptcy Court that has become final and not subject to possible appeal, review, certiorari or stay. If a court of competent jurisdiction determines that an Allowed Claim is held by a general partner of the debtor, then it shall be treated as a Class 7 Allowed Interest.

4. **Allowed Secured Claim** shall mean an

Allowed Claim secured by the Property in an amount equal to the lesser of the Allowed Claim of that creditor or the value of the Property, as determined by the Court pursuant to 11 U.S.C. Section 506, minus the amount of any Allowed Claim secured by any senior lien against the same Property, unless the holder of the claim elects, pursuant to Section 1111(b), in which event the Allowed Secured Claim shall be equal to the Allowed Claim.

5. **Code or Bankruptcy Code** shall mean Title 11 of the United States Code, 11 U.S.C. Sections 101-1330, as amended.

6. **Court or Bankruptcy Court** shall mean the United States Bankruptcy Court for the District of Connecticut, and, with respect to any particular proceeding arising under, in or relating to this Chapter 11 case, any other court which may have jurisdiction over such proceeding.

7. **Effective Date** shall mean the thirtieth business day after entry of an order confirming this Plan.

8. **Partnership Agreement** shall mean the Agreement of Partnership dated September 19, 1991 forming Boston Post Limited Partnership, and as amended from time to time thereafter.

9. **Plan** shall mean this Plan of Reorganization proposed by debtor, including any amendment or modification made in accordance with the applicable provisions of the Code.

10. **Property** shall mean the improved real property located at 161 Boston Post Road, Waterford, Connecticut.

11. **Reorganized Debtor** shall mean Boston Post Limited Partnership after the Effective Date.

B. Undefined Terms.

A term used in the Plan and not defined herein has the meaning ascribed to such term in the Bankruptcy Code

or Rules.

ARTICLE II

Classification of Claims and Interests

All Allowed Claims and Allowed Interests are placed in the following classes:

A. Class 1 (SECURED CLAIMS - Mortgage):

Class 1 consists of the Allowed Secured Claim held by Federal Deposit Insurance Corporation as Receiver of The Connecticut Bank and Trust Company, N.A. (FDIC), if any, that is secured by the Property. If FDIC files a ballot accepting the Plan, the amount of the Class 1 Allowed Secured Claim will be fully secured in the amount of FDIC's Allowed Claim. If FDIC does not file a ballot accepting the Plan, the amount of the Class 1 Allowed Secured Claim shall be the lesser of the amount of FDIC's Allowed Claim or an amount equal to the value of the Property, as determined by the Court pursuant to 11 U.S.C. Section 506. Alternatively, if FDIC elects under Section

1111(b), the amount of Class 1 Allowed Secured Claim shall be the amount of the Allowed Claim of FDIC.

B. **Class 2 (TENANT CLAIMS - Residential Security Deposits):** Class 2 consists of all Allowed Claims of residential tenants for pre-petition security deposits that are held by Debtor and placed with banking institutions as provided for by Connecticut General Statutes § 47(a)-21, together with accrued interest payable thereon at the statutory rate for such deposits.

C. **Class 3 (UNSECURED CLAIMS - trade debt and class 1 deficiency claims):** Class 3 consists of all unsecured Allowed Claims the holders of which do not also hold Allowed Secured Claims requiring the holder to first pursue its available remedies against the Property, including trade debt and all unsecured Allowed Claims the holders of which also hold Allowed Secured Claims requiring the holder of the Allowed Secured Claim to first pursue its available remedies against the Property with reference to the

same debt.

D. **Class 4 (PARTNERSHIP INTERESTS - limited partners):** Class 4 consists of the limited partnership interests held by a limited partner who will have the option under the Plan to make Additional Capital Contributions and retain a limited partnership interest or to not make a contribution and not retain any interest in the Reorganized Debtor.

E. **Class 5 (PARTNERSHIP INTERESTS - contributing general partners):** Class 5 consists of the general partnership interest held by the general partner who will make Additional Capital Contributions.

ARTICLE III

Treatment of Administration Claims and Certain Priority Claims

A. **Administration Claims:** The holders of Allowed Claims which are Administration Claims shall receive, on account of such claims, cash in the amount of

such claims (i) as soon as practical on or after the Effective Date or (ii) at the option of the Debtor, in accordance with the ordinary business terms of payment of such claims. Professionals employed at the expense of the estate of the Debtor and entities who may be entitled to reimbursement or the allowance of fees and expenses from the estate of the Debtor pursuant to subparagraphs (2) through (6) of Section 503(b) of the Bankruptcy Code, shall receive cash in the amount awarded to such professionals and entities at such times and only in accordance with a final order entered pursuant to Section 330 or Section 503(b)(2) through (6) of the Bankruptcy Code.

B. Unsecured Tax Claims: There are no claims in this class as all pre-petition real estate taxes have been paid in full and post petition real estate taxes are current. Since the Debtor is a limited partnership it is not liable for income taxes.

C. Priority Wage Claims: There are no claims in

this category since the Debtor, a real estate partnership, has never had direct employees.

ARTICLE IV

Designation and Treatment of Unimpaired Classes

There are no unimpaired classes under the Plan.

ARTICLE V

Acceptance or Rejection of Plan:
Effect of Rejection by One or More Classes of Claims

A. Impaired Classes to Vote. Each impaired class of Creditors with Claims or Equity Interest against the Debtor shall be entitled to vote separately to accept or reject the Plan.

B. Vote on Plan. Pursuant to Rule 3018(c) of the Rules of Bankruptcy Procedure, each impaired creditor shall vote, by single ballot, to accept or reject the Plan.

C. Acceptance by Class of Creditors. A Class of Creditors shall have accepted the Plan if the Plan is accepted by at least 2/3 in amount and more than 1/2 in number of the Allowed Claims of such class that have voted on the Plan.

D. Non-Acceptance by Class of Creditors. In the event that any impaired class of Creditors with Claims against any of the Debtor's estate shall fail to accept the Plan in accordance with Section 1129(a) of the Bankruptcy Code, the Debtor shall request the Bankruptcy Court to confirm the Plan in accordance with Section 1129(b) of the Bankruptcy Code over their objection.

ARTICLE VI

Treatment of Impaired Claims and Interests

A. General.

All classes of claims and all classes of interests are impaired under the Plan. All impaired classes of claims and interests shall receive the distributions set

forth in this Article on account of and in complete satisfaction of all such Allowed Claims (and any interest accrued thereon) and Allowed Interests. Without limiting the foregoing and effective upon the Effective Date, each creditor and each equity security holder (or its successor) shall be deemed to have waived, relinquished and released any and all of their rights and claims against the Debtor (other than as provided for in the Plan or the Court's order confirming the Plan).

B. Priority Claims.

There are no claims entitled to priority under the Code.

C. Secured Claims.

1. **Class 1 (Mortgage):** The holder of the Class 1 Allowed Secured Claim (FDIC) shall retain its lien securing such claim, and shall be paid as follows:

(a) With FDIC's Acceptance: If the holder of the Class 1 Allowed Secured Claim files a ballot accepting the Plan, the holder of the claim will

be fully secured in the amount of the holder's Allowed Claim plus accrued interest at the rate of 7.0%. The Allowed Secured Claim shall be paid in monthly payments, with all principal and accrued interest being due on the seventh anniversary of the Effective Date, as follows:

(i) year 1 - interest only at the rate of 7% per annum;

(ii) year 2 - interest only at the rate of 7% per annum;

(iii) year 3 - interest only at the rate of 7% per annum;

(iv) years 4 through 7 - amortized monthly payments, principal and interest with a 30-year amortization period at 7.0%.

This obligation shall be without recourse against the Reorganized Debtor, but all other terms and

conditions of the existing note, mortgage and other loan documents shall remain in full force and effect except as otherwise modified by this Plan. By voluntarily accepting this treatment, the Holder of the Class 1 Allowed Secured Claim waives and releases all claims against general partner and/or guarantor of the note and mortgage deed, and other loan documentation evidencing the claim of FDIC against the debtor for events of default that may now be in effect which events will be deemed cured by confirmation of the Plan.

(b) Without FDIC's Acceptance: If the Holder of the Class 1 Allowed Secured Claim does not file a ballot accepting the Plan, the obligation to pay the Class 1 Allowed Secured Claim shall be evidenced by a new note and mortgage deed and assignment of rents, and such obligation shall be without recourse to the Reorganized

Debtor.

(i) Without Section 1111(b) Election: If the holder of the Class 1 Allowed Secured Claim does not elect application of 11 U.S.C. Section 1111(b), the amount of the Class 1 Allowed Secured Claim shall be equal to the value of the Property, as determined by the Court pursuant to 11 U.S.C. Section 506. The Class 1 Allowed Secured Claim shall be paid in monthly payments with interest at a rate as determined by the Court to provide the Holder the present value of the Allowed Secured Claim (which debtor contends is 5.0%), with all principal and accrued interest being due on the tenth anniversary of the Effective Date, as follows:

years 1 through 3 - interest only at the rate of 5% per annum;

years 4 through 10 - amortized monthly payments, principal and interest with a 30-year amortization period at 5.0%.

(ii) With Section 1111(b) Election: If the holder of the Class 1 Allowed Secured Claim elects application of Section 1111(b), then the holder of

the Class 1 Allowed Secured Claim shall receive the same monthly and balloon payments as specified above as if the holder had not made the Section 1111(b) election, although the characterization of the principal and interest portions of those payments shall be modified as necessary to reflect the higher principal amount of the claim and lower imputed interest rate. In the event the total of such payments is less than the amount of the Allowed Secured Claim the difference shall be paid at the time of the final balloon payment, or upon sale of the Property, whichever occurs first, without interest.

2. **Class 2 (pre-petition secured residential security deposits):** Each holder of a Class 2 Claim, who is in possession of a residential unit on the Effective Date shall be deemed to have waived all claims to any unpaid pre-petition interest that may have otherwise been payable on account of such security deposit, whether payable by contract or otherwise; and shall waive the statutory requirement that such deposit be held in a separate escrow account; and shall be deemed to have granted permission

and authority to Debtor to utilize the deposit funds for the purpose of rehabilitating the claimants apartment unit in conjunction with additional capital contributions from the Partners. On vacating the apartment unit, such Claimant shall receive, on account of such security deposit less assessable damages, an unsecured promissory note of the debtor calling for payment of one-half of the pre-petition security deposit on or before thirty (30) days after the holder of such note actually vacates the premises, and the balance of the note to be paid one year after the holder vacates the premises together with interest at the rate of 5% per annum.

D. Unsecured Claims.

1. **Class 3 (trade debts and deficiency claims):** The holders of Class 3 Allowed Claims shall be paid in full, without interest at the earlier of the sale of the Property or the tenth anniversary of the Effective Date.

E. Partnership Interests.

1. **Class 4 (limited partner):** The holders of Class

4, Limited Partnership Allowed Interests, shall have the option, to be exercised prior to the Effective Date of the Plan, to make an additional capital contribution in an amount equal to that percentage of the total capital contribution required under the Plan that is equal to the ratio of their equity ownership of the debtor prior to the filing of the petition for relief under Title 11, United States Code, Chapter 11, to the total equity interest of the Partnership, which was 25% (one-fourth of the contributions, profits, losses and proceeds). If the limited partnership interests elect hereunder to make such contributions in accordance with the provisions of the Plan and thereafter do actually make such contributions, the Class 4 limited partnership interests shall retain ownership in the Reorganized Debtor and have all the rights afforded a limited partner under the terms of the Partnership Agreement. If the limited partnership interests do not make such election prior to the Effective Date or having made such election fail to make

such 25% share of the capital contributions required by the Plan, the Class 4 Interests shall not receive or retain any property under the Plan, shall be deemed to have withdrawn from the partnership as of the Effective Date, if not earlier, and shall forfeit, waive and release their partnership interests and their interests in or claims against the partnership and as against the general partner interests and the general partner.

2. **Class 5 (contributing general partner):** The holders of the Class 5 Allowed Interests shall make an Additional Capital Contribution in an amount necessary and sufficient to meet all tenant improvements, deferred maintenance, any broker commission obligations of the partnership, and cash funds required for confirmation under provisions of the Plan and any deficiency in the cash flow of the property necessary to meet the Debtor's financial obligations under the Plan up to the sum of $200,000.00, less the amount contributed by the Class 4 limited

partnership interests, if any. The contributing general partner shall be the general partner of the Reorganized Debtor and shall have all the rights and obligations as set forth in the Partnership Agreement. If the Class 6 limited partnership interests do not make the required capital contribution under the Plan and the limited partnership interest therefore do not retain any interest in the Reorganized Debtor, the Property shall thereupon vest solely in the ownership of the Class 5 contributing interest and the Reorganized Debtor shall be operated as a limited partnership with the present general partner constituting both the limited partner to the extent of a 25% ownership interest and the general partner to the extent of a 75% ownership interest, under the same terms as set forth in the Plan as would have been utilized if the Reorganized Debtor were operated as a limited partnership with the present limited partner making the contributions required under the Plan including the provisions relating to the non-recourse nature

of the debts of the debtor after confirmation of the Plan.

ARTICLE VII

Means for Execution of the Plan

A. Source of Operating Funds.

Debtor's projections show that there will be sufficient net operating income to pay all administrative expenses and all classes of claims as provided under the Plan. The Reorganized Debtor will incur expenses for tenant improvements and broker commissions as a result of its leasing efforts, There may be a shortfall in net operating income to pay these expenses. The deficiency will be satisfied from the following sources: (1) net operating income that is sequestered during the pendency of the Chapter 11 case, if any; (2) Additional Capital Contributions by the Class 4 limited partner and/or the Class 5 general partner; and/or possible sale of additional limited partnership interests. **Exhibit A** to the Disclosure Statement sets forth the Debtor's Projections.

B. Management.

The existing property management company is Boyer Realty Management, an affiliate of the general partner of the Debtor. Boyer Realty Management, will continue to manage the Reorganized Debtor's Property. Leasing may be done, at least initially, by utilizing independent leasing agents in the community, for a 5% commission, subject to change at the discretion of the Reorganized Debtor. Management of the Reorganized Debtor shall remain unchanged with customary property management fees being accrued to the account of the property manager and being paid as the cash flow of the Reorganized Debtor permits, taking into consideration the payment requirements under the Plan. Fees owing the affiliated property manager shall be subordinate to the payments to creditors under the Plan. The general partner shall have broad authority with respect to the conduct of the business of the Reorganized Debtor, including the rights and power to enter into agreements

regarding a sale of the Property and to borrow money to pay partnership obligations together with any and all rights and authority granted under the Partnership Agreement and the Connecticut Uniform Limited Partnership Act.

C. Surrender and Cancellation of Debt Instruments and Security.

No holder of a promissory note, payment guaranty, assignment of rents or other transferable instrument (collectively "instrument") the terms of which are modified under the Plan shall receive any distribution under the Plan until such instrument has been surrendered to, or satisfactory evidence of loss has been provided to the partnership. Any holder of an instrument that fails to surrender such instrument or provide satisfactory evidence of loss thereof within twelve months after the Effective Date shall be deemed to have no further claim against or in the Debtor or the Reorganized Debtor and shall receive no distribution under the Plan and such distribution which otherwise would

have been made to such holder will thereafter become the unencumbered property of the partnership.

The general partner shall have no liability for claims against or liabilities of the partnership that arose or accrued prior to the Effective Date, including but not limited to Allowed Claims and Allowed Interests dealt with under the Plan, and administrative expenses. All secured claims shall have recourse only to the collateral securing such claims, and all unsecured claims and interests shall have recourse only to the partnership, not the new general partner of the Reorganized Debtor.

D. De Minimis Distributions.

Notwithstanding anything to the contrary herein, no distribution of cash shall be made hereunder in an amount less than $10. All cash not distributed pursuant to this provision shall vest in the partnership free of any claim.

ARTICLE VIII

Effect of Confirmation

Except as otherwise provided in the Plan or in the Court's order confirming the Plan (the "Confirmation Order"), the Confirmation Order acts as a discharge, effective as of the Effective Date, of any and all debts of the debtor that arose at any time before the entry of the Confirmation Order, including, but not limited to, all principal and any and all interest accrued thereon, pursuant to section 1141(d)(1) of the Bankruptcy Code. The discharge of the debtor shall be effective as to each claim, regardless of whether a proof of claim thereof was filed, whether the claim is an Allowed Claim or whether the holder thereof votes to accept the Plan.

Pursuant to 11 U.S.C. Sections 1125(e) and 1145, the solicitation and sale of interests represented by any Additional Capital Contributions are exempt from all non-bankruptcy laws, rules or regulations governing the offer, issuance, sale or purchase of securities and from Section 5 of the Securities Act of 1933 and any state or local law

requiring registration for offer or sale of a security or licensing of an underwriter, broker or dealer in a security.

ARTICLE IX

Retention and Enforcement of Claims

Pursuant to Section 1123(b)(3) of the Bankruptcy Code, the Reorganized Debtor shall retain and may enforce any and all claims of the Debtor, except claims waived, relinquished and released in accordance with the Plan. Pre-petition claims against the debtor's general partner held by creditors who do not file acceptances of this Plan, if any, shall be preserved but may not be enforced unless and until there has been a default by the Reorganized Debtor or its general partner of their obligations under the confirmed Plan and the affected creditor has given thirty (30) days' written notice thereof to the Reorganized Debtor and its general partner. All obligations of the Reorganized Debtor pursuant to the confirmed Plan, however, shall be without recourse to the debtor's general partner.

ARTICLE X

Executory Contracts

All executory contracts of the debtor are rejected pursuant to the provisions of Sections 365 and 1123 of the Bankruptcy Code other than unexpired leases of tenants of the Property which are hereby assumed as an express provision of the Plan.

ARTICLE XI

Provisions for Modification of the Plan

The Debtor may propose amendments or modifications of this Plan at any time prior to confirmation with leave of the Court, upon notice to the Creditor's Committee. After confirmation, the Debtor may, with approval of the Court, and so long as it does not materially or adversely affect the interests of creditors, remedy any defect or omission, or reconcile any inconsistencies in the Plan, or in the order of confirmation, in such manner as may be necessary to carry out the purposes and effect of this

Plan. The foregoing provisions of this Article XI do not limit the ability of any party to modify the Plan under 11 U.S. C. § 1127, and applicable rules.

ARTICLE XII

Closing of the Case

At such time as the Case has been fully administered, that is, when all things requiring action by the Court have been done, and the Plan has been Substantially Consummated, this case shall be closed. To close the Case, the Debtor shall file an application for final decree showing that the Case has been fully administered and that the Plan has been Substantially Consummated. The Court shall conduct a hearing upon the application after notice to all creditors, equity security holders and persons specially requesting notices, after which an order approving the Debtor's report and closing the Case (final decree) may be entered.

In the period after Confirmation but before closing

of the Case, the Debtor may continue to avail itself of the services of professional persons whose employment was approved at or prior to Confirmation in completing administration of the Case and in the consummation and performance of the Plan, and, if necessary, with approval of the Court employ additional professional persons to render services in and in connection with the Case. With respect to services rendered and expenses incurred in or in connection with the Case by any professional person during such period, the professional person may render periodic billings therefor to the Debtor which shall promptly pay the same, but each such payment shall be subject to review and approval by the Court as to the reasonableness thereof, as set forth hereinbelow. In its application for final decree the Debtor shall detail all amounts paid during such period to professional persons as compensation for services rendered or reimbursement of expenses incurred, and with respect to which no prior allowance thereof has been made by the

Court. At the hearing on the Debtor's application for final decree the Court shall consider and determine whether or not such payments shall be approved as reasonable.

ARTICLE XIII

Revesting

Except as provided for in the Plan or in the Order confirming the Plan, on the Effective Date the Reorganized Debtor shall be vested with all of the property of its estate free and clear of all claims, liens, charges and other interests of creditors arising prior to the filing date. Upon the Effective Date the Reorganized Debtor shall operate its business free of any restrictions.

ARTICLE XIV

Retention of Jurisdiction

Notwithstanding confirmation of this Plan, the Bankruptcy Court shall retain jurisdiction for the following purposes:

1. Determination of the allowability of claims

and interests upon objection to such claims by the Debtor, the reorganized Debtor, or by any other party in interest.

2. Determination of requests for payment of claims entitled to priority under Section 507(a)(1) of the Bankruptcy Code, including compensation of parties entitled thereto.

3. Resolution of controversies and disputes regarding the interpretation or enforcement of the terms of the Plan, any of the instruments issued under the Plan or any other documentation evidencing the terms of the Plan.

4. Implementation of the provisions of the Plan and entry of orders in aid of confirmation of the Plan, including, without limitation, appropriate orders to protect the reorganized Debtor.

5. Entry of a final decree closing the Debtor's case.

ARTICLE XV

Condition of Confirmation

The Plan shall not be confirmed unless the Class 5 General partner agrees to make the required Additional Capital Contributions, and such Additional Capital Contributions shall be deemed exempt from the securities laws pursuant to Section 1145 of the Code.

ARTICLE XVI

Effect on Prior Plan

The Debtor's Third Amended First Plan of Reorganization was denied confirmation at the adjourned confirmation hearing held on October 2, 1992. The Debtor respectfully disagreed with the Courts legal findings in connection with that denial and has therefor taken an appeal of the denial of confirmation to the United States District Court for the District of Connecticut which appeal is now pending. The submission this Second Plan of Reorganization is without prejudice to the prosecution of the appeal. In the event that

this Second Plan of Reorganization is confirmed by the Court at a confirmation hearing and the order confirming this Plan becomes final, the appeal of the prior plan will be withdrawn.

Respectfully submitted, this 17th day of December, 1992.

BOSTON POST LIMITED PARTNERSHIP, Debtor

By /s/ George K. Boyer

28 U.S.C. § 1254. Courts of appeals; certiorari; certified questions

Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:

(1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree;

(2) By certification at any time by a court of appeals of any question of law in any civil or criminal case as to which instructions are desired, and upon such certification the Supreme Court may give binding instructions or require the entire record to be sent up for decision of the entire matter in controversy.

11 U.S.C. § 1111. Claims and interests

(a) A proof of claim or interest is deemed filed under section 501 of this title for any claim or interest that appears in the schedules filed under section 521(1) or 1106(a)(2) of this title, except a claim or interest that is scheduled as disputed, contingent, or unliquidated.

(b)(1)(A) A claim secured by a lien on property of the estate shall be allowed or disallowed under section 502 of this title the same as if the holder of such claim had recourse against the debtor on account of such claim, whether or not such holder has such recourse, unless--

(i) the class of which such claim is a part elects, by at least two-thirds in amount and more than half in number of allowed claims of such class, application of paragraph (2) of this subsection; or

(ii) such holder does not have such recourse and such property is sold under section 363 of this title or is to be sold under the plan.

(B) A class of claims may not elect application of paragraph (2) of this subsection if--

(i) the interest on account of such claims of the holders of such claims in such property is of inconsequential value; or

(ii) the holder of a claim of such class has recourse against the debtor on account of such claim and such property is sold under section 363 of this title or is to be sold under the plan.

(2) If such an election is made, then notwithstanding

section 506(a) of this title, such claim is a secured claim to the extent that such claim is allowed.

11 U.S.C. § 1122. Classification of claims or interests

(a) Except as provided in subsection (b) of this section, a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class.

(b) A plan may designate a separate class of claims consisting only of every unsecured claim that is less than or reduced to an amount that the court approves as reasonable and necessary for administrative convenience.

11 U.S.C. § 1123. Contents of plan

(a) Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall--

(1) designate, subject to section 1122 of this title, classes of claims, other than claims of a kind specified in section 507(a)(1), 507(a)(2), or 507(a)(7) of this title, and classes of interests;

(2) specify any class of claims or interests that is not impaired under the plan;

(3) specify the treatment of any class of claims or interests that is impaired under the plan;

(4) provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest;

(5) provide adequate means for the plan's implementation, such as--

(A) retention by the debtor of all or any part of the property of the estate;

(B) transfer of all or any part of the property of the estate to one or more entities, whether organized before or after the confirmation of such plan;

(C) merger or consolidation of the debtor with one or more persons;

(D) sale of all or any part of the property of the

estate, either subject to or free of any lien, or the distribution of all or any part of the property of the estate among those having an interest in such property of the estate;

(E) satisfaction or modification of any lien;

(F) cancellation or modification of any indenture or similar instrument;

(G) curing or waiving of any default;

(H) extension of a maturity date or a change in an interest rate or other term of outstanding securities;

(I) amendment of the debtor's charter; or

(J) issuance of securities of the debtor, or of any entity referred to in subparagraph (B) or (C) of this paragraph, for cash, for property, for existing securities, or in exchange for claims or interests, or for any other appropriate purpose;

(6) provide for the inclusion in the charter of the debtor, if the debtor is a corporation, or of any corporation referred to in paragraph (5)(B) or (5)(C) of this subsection, of a provision prohibiting the issuance of nonvoting equity securities, and providing, as to the several classes of securities possessing voting power, an appropriate distribution of such power among such classes, including, in the case of any class of equity securities having a preference over another class of equity securities with respect to dividends, adequate provisions for the election of directors representing such preferred class in the event of default in the payment of such dividends; and

(7) contain only provisions that are consistent with the interests of creditors and equity security holders and with public policy with respect to the manner of selection of any officer, director, or trustee under the plan and any successor to such officer, director, or trustee.

(b) Subject to subsection (a) of this section, a plan may--

(1) impair or leave unimpaired any class of claims, secured or unsecured, or of interests;

(2) subject to section 365 of this title, provide for the assumption, rejection, or assignment of any executory contract or unexpired lease of the debtor not previously rejected under such section;

(3) provide for--

(A) the settlement or adjustment of any claim or interest belonging to the debtor or to the estate; or

(B) the retention and enforcement by the debtor, by the trustee, or by a representative of the estate appointed for such purpose, of any such claim or interest;

(4) provide for the sale of all or substantially all of the property of the estate, and the distribution of the proceeds of such sale among holders of claims or interests; and

(5) include any other appropriate provision not inconsistent with the applicable provisions of this title.

(c) In a case concerning an individual, a plan

proposed by an entity other than the debtor may not provide for the use, sale, or lease of property exempted under section 522 of this title, unless the debtor consents to such use, sale, or lease.

11 U.S.C. § 1124. Impairment of claims or interests

Except as provided in section 1123(a)(4) of this title, a class of claims or interests is impaired under a plan unless, with respect to each claim or interest of such class, the plan--

(1) leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest;

(2) notwithstanding any contractual provision or applicable law that entitles the holder of such claim or interest to demand or receive accelerated payment of such claim or interest after the occurrence of a default--

(A) cures any such default that occurred before or after the commencement of the case under this title, other than a default of a kind specified in section 365(b)(2) of this title;

(B) reinstates the maturity of such claim or interest as such maturity existed before such default;

(C) compensates the holder of such claim or interest for any damages incurred as a result of any reasonable reliance by such holder on such contractual provision or such applicable law; and

(D) does not otherwise alter the legal, equitable, or contractual rights to which such claim or interest entitles the holder of such claim or interest; or

(3) provides that, on the effective date of the plan, the holder of such claim or interest receives, on account of

such claim or interest, cash equal to--

(A) with respect to a claim, the allowed amount of such claim; or

(B) with respect to an interest, if applicable, the greater of--

(i) any fixed liquidation preference to which the terms of any security representing such interest entitle the holder of such interest; or

(ii) any fixed price at which the debtor, under the terms of such security, may redeem such security from such holder.

11 U.S.C. § 1126. Acceptance of plan

(a) The holder of a claim or interest allowed under section 502 of this title may accept or reject a plan. If the United States is a creditor or equity security holder, the Secretary of the Treasury may accept or reject the plan on behalf of the United States.

(b) For the purposes of subsections (c) and (d) of this section, a holder of a claim or interest that has accepted or rejected the plan before the commencement of the case under this title is deemed to have accepted or rejected such plan, as the case may be, if--

(1) the solicitation of such acceptance or rejection was in compliance with any applicable nonbankruptcy law, rule, or regulation governing the adequacy of disclosure in connection with such solicitation; or

(2) if there is not any such law, rule, or regulation, such acceptance or rejection was solicited after disclosure to such holder of adequate information, as defined in section 1125(a) of this title.

(c) A class of claims has accepted a plan if such plan has been accepted by creditors, other than any entity designated under subsection (e) of this section, that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors, other than any entity designated under subsection (e) of this section, that have accepted or rejected such plan.

(d) A class of interests has accepted a plan if such plan has been accepted by holders of such interests, other than any entity designated under subsection (e) of this

section, that hold at least two-thirds in amount of the allowed interests of such class held by holders of such interests, other than any entity designated under subsection (e) of this section, that have accepted or rejected such plan.

(e) On request of a party in interest, and after notice and a hearing, the court may designate any entity whose acceptance or rejection of such plan was not in good faith, or was not solicited or procured in good faith or in accordance with the provisions of this title.

(f) Notwithstanding any other provision of this section, a class that is not impaired under a plan, and each holder of a claim or interest of such class, are conclusively presumed to have accepted the plan, and solicitation of acceptances with respect to such class from the holders of claims or interests of such class is not required.

(g) Notwithstanding any other provision of this section, a class is deemed not to have accepted a plan if such plan provides that the claims or interests of such class do not entitle the holders of such claims or interests to receive or retain any property under the plan on account of such claims or interests.

11 U.S.C. § 1129. Confirmation of plan

(a) The court shall confirm a plan only if all of the following requirements are met:

(1) The plan complies with the applicable provisions of this title.

(2) The proponent of the plan complies with the applicable provisions of this title.

(3) The plan has been proposed in good faith and not by any means forbidden by law.

(4) Any payment made or to be made by the proponent, by the debtor, or by a person issuing securities or acquiring property under the plan, for services or for costs and expenses in or in connection with the case, or in connection with the plan and incident to the case, has been approved by, or is subject to the approval of, the court as reasonable;

(5)(A)(i) The proponent of the plan has disclosed the identity and affiliations of any individual proposed to serve, after confirmation of the plan, as a director, officer, or voting trustee of the debtor, an affiliate of the debtor participating in a joint plan with the debtor, or a successor to the debtor under the plan; and

(ii) the appointment to, or continuance in, such office of such individual, is consistent with the interests of creditors and equity security holders and with public policy; and

(B) the proponent of the plan has disclosed the

identity of any insider that will be employed or retained by the reorganized debtor, and the nature of any compensation for such insider.

(6) Any governmental regulatory commission with jurisdiction, after confirmation of the plan, over the rates of the debtor has approved any rate change provided for in the plan, or such rate change is expressly conditioned on such approval.

(7) With respect to each impaired class of claims or interests--

(A) each holder of a claim or interest of such class--

(i) has accepted the plan; or

(ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date; or

(B) if section 1111(b)(2) of this title applies to the claims of such class, each holder of a claim of such class will receive or retain under the plan on account of such claim property of a value, as of the effective date of the plan, that is not less than the value of such holder's interest in the estate's interest in the property that secures such claims.

(8) With respect to each class of claims or interests--

(A) such class has accepted the plan; or

(B) such class is not impaired under the plan.

(9) Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that--

(A) with respect to a claim of a kind specified in section 507(a)(1) or 507(a)(2) of this title, on the effective date of the plan, the holder of such claim will receive on account of such claim cash equal to the allowed amount of such claim;

(B) with respect to a class of claims of a kind specified in section 507(a)(3), 507(a)(4), 507(a)(5) or 507(a)(6) of this title, each holder of a claim of such class will receive--

(i) if such class has accepted the plan, deferred cash payments of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) if such class has not accepted the plan, cash on the effective date of the plan equal to the allowed amount of such claim; and

(C) with respect to a claim of a kind specified in section 507(a)(7) of this title, the holder of such claim will receive on account of such claim deferred cash payments, over a period not exceeding six years after the date of assessment of such claim, of a value, as of the effective date of the plan, equal to the allowed amount of such claim.

(10) If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any

acceptance of the plan by any insider.

(11) Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.

(12) All fees payable under section 1930, as determined by the court at the hearing on confirmation of the plan, have been paid or the plan provides for the payment of all such fees on the effective date of the plan.

(13) The plan provides for the continuation after its effective date of payment of all retiree benefits, as that term is defined in section 1114 of this title, at the level established pursuant to subsection (e)(1)(B) or (g) of section 1114 of this title, at any time prior to confirmation of the plan, for the duration of the period the debtor has obligated itself to provide such benefits.

(b)(1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

(A) With respect to a class of secured claims, the plan provides--

(i)(I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and

(II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;

(ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or

(iii) for the realization by such holders of the indubitable equivalent of such claims.

(B) With respect to a class of unsecured claims--

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any

property.

(C) With respect to a class of interests--

(i) the plan provides that each holder of an interest of such class receive or retain on account of such interest property of a value, as of the effective date of the plan, equal to the greatest of the allowed amount of any fixed liquidation preference to which such holder is entitled, any fixed redemption price to which such holder is entitled, or the value of such interest; or

(ii) the holder of any interest that is junior to the interests of such class will not receive or retain under the plan on account of such junior interest any property.

(c) Notwithstanding subsections (a) and (b) of this section and except as provided in section 1127(b) of this title, the court may confirm only one plan, unless the order of confirmation in the case has been revoked under section 1144 of this title. If the requirements of subsections (a) and (b) of this section are met with respect to more than one plan, the court shall consider the preferences of creditors and equity security holders in determining which plan to confirm.

(d) Notwithstanding any other provision of this section, on request of a party in interest that is a governmental unit, the court may not confirm a plan if the principal purpose of the plan is the avoidance of taxes or the avoidance of the application of section 5 of the Securities Act of 1933 (15 U.S.C. 77e). In any hearing under this subsection, the governmental unit has the burden of proof on the issue of avoidance.

(3)

Supreme Court, U.S
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No. 94-442

In the Supreme Court of the United States

OCTOBER TERM, 1994

IN RE BOSTON POST ROAD LIMITED PARTNERSHIP, DEBTOR

BOSTON POST ROAD LIMITED PARTNERSHIP, PETITIONER

v.

FEDERAL DEPOSIT INSURANCE CORPORATION, AS RECEIVER OF THE NEW CONNECTICUT BANK AND TRUST COMPANY, N.A.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the court of appeals was correct in holding that Sections 1122 and 1129 of the Bankruptcy Code, 11 U.S.C. 1122 and 1129, prohibit a Chapter 11 debtor from proposing a plan of reorganization that places an undersecured deficiency claim arising from a recourse note in a class separate from the claims of the general unsecured creditors in order to gerrymander an affirmative vote on the reorganization plan and "cram down" the plan over the objections of the undersecured creditor.

2. Whether the court of appeals was correct in holding that the security deposit claims of residential lessees in this case, whose leases had been assumed by the bankruptcy estate, did not comprise an "impaired" class within the meaning of Section 1124 of the Bankruptcy Code, 11 U.S.C. 1124.

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v.

FEDERAL DEPOSIT INSURANCE CORPORATION, AS RECEIVER OF THE NEW CONNECTICUT BANK AND TRUST COMPANY, N.A.

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 36-64) is reported at 21 F.3d 477. The opinion of the district court (Pet. App. 17-35) is reported at 154 B.R. 617. The opinion of the bankruptcy court (Pet. App. 1-16) is reported at 145 B.R. 745.

JURISDICTION

The judgment of the court of appeals was entered on March 30, 1994. A petition for rehearing was denied on June 14, 1994 (Pet. App. 101-102). The petition for a writ of certiorari was filed on September 12, 1994. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner, a Connecticut limited partnership, was formed in 1984 to acquire, own, and manage a residential and office complex located in Waterford, Connecticut (the Property). Pet. App. 2-3, 37-38. In March 1988, petitioner mortgaged the Property to the Connecticut Bank and Trust Company, N.A. (the Bank), to secure a loan of approximately $1.6 million. *Id.* at 2-3, 38. Petitioner subsequently defaulted on the mortgage payments and, on July 20, 1990, the Bank commenced foreclosure proceedings in Connecticut Superior Court. *Id.* at 3, 38. After the Bank itself failed in January 1991, the Federal Deposit Insurance Corporation (FDIC), as receiver, was substituted as the plaintiff in the foreclosure action. *Id.* at 3, 38. On August 1, 1991, the Superior Court entered a judgment of strict foreclosure in favor of the FDIC. *Id.* at 3, 38-39. October 28, 1991, was set as petitioner's last day to redeem the Property. *Ibid.* On that date, petitioner filed for protection in the United States Bankruptcy Court for the District of Connecticut under Chapter 11 of the Bankruptcy Code, 11 U.S.C. 1100 *et seq.*, thereby staying foreclosure. *Id.* at 3, 39.

2. Petitioner filed its Second Amended Plan of Reorganization (Plan) on June 18, 1992. Under the Plan, petitioner proposed seven classes of creditors: Class 1—unsecured claims of residential tenants to their security

deposits; Class 2—the FDIC's secured claim; Class 3—secured claims of residential tenants whose security deposits are held by petitioner in interest-bearing bank accounts; Class 4—unsecured claims of general trade creditors; Class 5—the FDIC's unsecured deficiency claim; Class 6—partnership interests of the limited partner; and Class 7—partnership interests of the general partner. Pet. App. 39-40. The Plan proposed to pay the tenants' security deposit claims in full, with interest at 8 percent per annum (which represented a "bonus" of 2.75 percent over the then-statutorily mandated 5.25 percent rate), and to pay the general unsecured trade creditors (whose claims total about $5000) in full, without interest, over a six-year period. *Id.* at 3-5, 40-41. With respect to the FDIC's claims, the Plan was less generous. Petitioner proposed to pay the FDIC's $1,445,000 secured claim over 15 years, with negative amortization and a balloon payment at the end of the fifteenth year, and to pay the FDIC's $500,000 unsecured deficiency claim over 15 years or until the Property was sold (whichever came first), without interest. *Id.* at 4, 40.[1] Class 1 turned out to be nonexistent; Classes 2 and 5 (*i.e.*, the FDIC) objected to and voted to reject the Plan; and Classes 3, 4, 6, and 7 voted to accept the Plan. *Id.* at 5, 41.

3. At the confirmation hearing on August 12, 1992, petitioner contended that, based on the affirmative votes of Classes 3 (the residential security deposit holders)

[1] The parties agreed that the value of the Property was $1,445,000. Because the FDIC chose, under 11 U.S.C. 1111(b)(2), to have its deficiency claim treated as a separate unsecured claim, the aggregate $1,945,000 debt owed to the FDIC is made up of a secured claim for $1,445,000 and an unsecured deficiency claim for the remaining $500,000. Pet. App. 4 n.3, 5, 40 n.1, 44.

and 4 (the general unsecured trade creditors), both of which petitioner claimed were "impaired" classes within the meaning of Section 1124 of the Bankruptcy Code, 11 U.S.C. 1124, petitioner was entitled to cram down[2] the Plan over the FDIC's objections.

The bankruptcy court denied confirmation. It held that the fact that each residential tenant would receive "bonus" interest under the Plan did not render the tenants' claims "impaired," because the payment of additional interest would not alter the tenants' preexisting rights to the return of their security deposits with 5.25 percent accrued interest upon vacating the property. In the court's view, "to provide for additional interest to be paid on tenants' security deposits in order to create an *impaired* class is to turn the doctrine of impairment * * * on its head and is totally impermissible. If [petitioner] were correct, * * * any time a plan proponent needed an impaired class for a favorable vote, the debtor would simply add $1.00 to such class members' claims." Pet. App. 9-10 (emphasis added).

Turning next to the proposed separation of the FDIC's deficiency claim from the claims of the general unsecured trade creditors, the court adopted the uniformly held view that the Code prohibits a debtor from "classifying similar claims differently in order to gerrymander an affirmative vote in favor of a reorganization plan." *Id.* at 11. Finding no legal or business

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[2] "Cram down" refers to a procedure allowed by Section 1129(b) of the Bankruptcy Code, 11 U.S.C. 1129(b), whereby a plan of reorganization may be confirmed despite the plan's rejection by one or more classes of creditors, so long as various requirements are met, including the requirement that at least one class of impaired creditors has voted to accept the plan.

rationale that justified placing the FDIC's undersecured claim in a separate class, the court held that the FDIC should have been included in Class 4 with the other unsecured creditors, which would have resulted in a negative vote by that class given the size of the FDIC's claim. *Id.* at 10-15.

The district court agreed with the reasoning of the bankruptcy court[3] and affirmed the order denying confirmation. *Id.* at 17-35.

4. The court of appeals affirmed. Pet. App. 36-64. The court concluded, as had the bankruptcy and district courts before it, that petitioner should have included the FDIC's under-secured claim in the class of general unsecured claims, which would have prevented that class from voting in favor of the Plan. *Id.* at 63-64. The court of appeals also shared those courts' skepticism with respect to petitioner's argument that the residential tenants would be "impaired" within the meaning of Section 1124 by the promise of additional interest, but found it unnecessary to decide that issue. Pet. App. 59-60. As the court explained, because petitioner had assumed the tenants' leases, "the leases ha[d] no provable claim against the bankruptcy estate," and instead constituted post-petition priority administrative claims, which carry no right to vote on a plan of reorganization. *Id.* at 61-62. The vote of the residential tenants in favor of the Plan could not, therefore, justify a "cram down" over the objections of the FDIC. *Id.* 62-63.

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[3] See Pet. App. 34 ("[T]he fact that the value of a claim is enhanced by a plan has no bearing on whether the class of claims is impaired, absent a finding that the rights of the class are altered as well."); *id.* at 31 ("[T]he court agrees with the Bankruptcy Court that the only reason for [petitioner] to segregate the substantially similar unsecured claims is 'to fabricate an accepting class under 11 U.S.C. § 1129(a)(10) in order to effectuate a cramdown.'").

ARGUMENT

The court of appeals correctly applied settled law in deciding that petitioner's Plan could not be confirmed because there was no assent of an impaired non-insider class of creditors. Its decision does not conflict with any decision of this Court or of any other court of appeals.

1. Petitioner argues (Pet. 17-21) that the court of appeals' decision in this case conflicts with the Seventh Circuit's decision in *In re Woodbrook Assocs.*, 19 F.3d 312, 318 (1994). In *Woodbrook*, the Seventh Circuit held that an unsecured claim arising out of a nonrecourse obligation was substantially different from other unsecured claims and therefore could be placed in a separate class. The factual circumstances of this case, however, distinguish it from *Woodbrook*, as well as from most other cases that have dealt with the issue of whether the separate classification of undersecured claims is permissible under Chapter 11.

The courts of appeals have uniformly concluded that, although Section 1122(a) of the Bankruptcy Code, 11 U.S.C. 1122(a), does not expressly prohibit the separate classification of similar claims, a plan proponent may not separately classify similar claims for the sole purpose of manipulating the plan confirmation voting process.[4]

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[4] See *In re Greystone III Joint Venture*, 995 F.2d 1274, 1279 (5th Cir. 1991) (setting forth the "one clear rule" regarding claims classification by debtors: "[T]hou shalt not classify similar claims differently in order to gerrymander an affirmative vote on a reorganization plan."), cert. denied, 113 S. Ct. 72 (1992); see also *John Hancock Mut. Life Ins. Co.* v. *Route 37 Business Park Assocs.*, 987 F.2d 154, 159 (3d Cir. 1993); *In re Lumber Exch. Bldg. Ltd. Partnership*, 968 F.2d 647, 649 (8th Cir. 1992); *In re Bryson Properties, XVIII*, 961 F.2d 496, 502 (4th Cir.), cert. denied, 113 S. Ct. 191 (1992); *In re Holywell Corp.*, 913 F.2d 873, 880 (11th Cir. 1990); *In re U.S. Truck Co.*, 800 F.2d 581, 586 (6th Cir. 1986); cf.

The courts agree, however, that a claim may be placed in a class separate from claims similar to it when legitimate reasons support the separate classification.

In *Woodbrook*, the Seventh Circuit held that a Section 1111(b) undersecured deficiency claim that arises from a nonrecourse loan, is "not substantially similar" to the claims of other unsecured creditors. 19 F.3d at 318. The disparity, the court explained, "stem[s] from the most obvious difference between the two claims: a general unsecured claim exists in all chapters of the [Bankruptcy] Code, while a § 1111(b) claim exists only as long as the case remains in Chapter 11 and, once converted to a Chapter 7 case, recovery is limited to its collateral." *Ibid.*[5]

Granada Wines, Inc. v. *New England Teamsters & Trucking Indus. Pension Fund*, 748 F.2d 42, 46-47 (1st Cir. 1984) (stating that all creditors of equal rank should be grouped in the same class). Although the court in *Woodbrook* noted that it may be difficult in practice to determine whether a debtor has placed claims in separate classes for a bad purpose, it acknowledged that "limits [on the debtor's discretion to classify claims and interests] are necessary to offset a debtor's incentive to manipulate a classification scheme and ensure the affirmative vote of at least one impaired class," 19 F.3d at 318.

[5] The court in *Woodbrook* also noted that an undersecured creditor may have different interests in bankruptcy from those of a general unsecured creditor. 19 F.3d at 318. It suggested that an undersecured creditor "may vote its large deficiency claim to defeat any plan, obtain relief from the automatic stay and foreclose, while the general unsecured claimant has a strong incentive to vote to accept the plan because it may receive nothing from liquidating the debtor if the automatic stay is lifted." *Ibid.* The majority of circuits have held that those differing incentives do not support separate classification. See, *e.g.*, *John Hancock Mutual Life Ins. Co.*, 987 F.2d at 161 ("Absent bad faith or illegality, the [Bankruptcy] Code is not concerned with a claim holder's reason for voting one way or the other, and undoubtedly

As the Seventh Circuit recognized, see *Woodbrook*, 19 F.3d at 318, all of the other courts of appeals that have considered the matter have ruled to the contrary, holding that the fact that a deficiency claim has been created from a nonrecourse loan by action of law under Chapter 11 does not mean that such a claim, once created, should be treated differently under Chapter 11 from other unsecured claims. See, *e.g.*, *In re Greystone III Joint Venture*, 995 F.2d 1274, 1278 (5th Cir. 1991), cert. denied, 113 S. Ct. 72 (1992); *John Hancock Mut. Life Ins. Co.* v. *Route 37 Business Park Assocs.*, 987 F.2d 154, 159 (3d Cir. 1993); *In re Lumber Exch. Bldg. Ltd. Partnership*, 968 F.2d 647, 649 (8th Cir. 1992); *In re Bryson Properties, XVIII*, 961 F.2d 496, 502 (4th Cir.), cert. denied, 113 S. Ct. 191 (1992). To the extent that *Woodbrook* has created a circuit conflict on the issue, that conflict cannot be resolved in this case. Here, the FDIC's unsecured claims arose not from Section 1111(b) of the Bankruptcy Code, but instead as a matter of contract, through petitioner's *recourse* obligation. Because the deficiency claim would be treated under state law as an ordinary unsecured debt, the FDIC would not be limited to its collateral as a source of recovery if this case were converted to Chapter 7. Accordingly, the "significant disparities" between the undersecured creditor and general unsecured creditors that the

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most claim holders vote in accordance with their overall economic interests as they see them.") (citation omitted); *Greystone III*, 995 F.2d at 1279-1280. Although the Seventh Circuit found the incentives-based distinction "worthy of careful study," it reserved judgment on whether the distinction justifies separate classification of undersecured and unsecured claims. See *Woodbrook*, 19 F.3d at 318.

Seventh Circuit found dispositive in *Woodbrook* do not exist here.

2. Petitioner also contests (Pet. 21-28) the lower courts' determination that the residential tenants' security deposit claims do not comprise an "impaired" class. In petitioner's view, because the residential security deposit holders were to receive "bonus" interest under the Plan, the Plan "impaired" the claims of those security deposit holders. That argument is without merit.

The court of appeals correctly determined that because petitioner neither assumed nor rejected the tenants' leases, the leases were assumed by petitioner as a matter of law, and the tenants therefore have no pre-petition claims against the bankruptcy estate with respect to their security deposits. See *Greystone III*, 995 F.2d at 1281; *In re Whitcomb & Keller Mortgage Co.*, 715 F.2d 375, 378-379 (7th Cir. 1983); *In re Cochise College Park, Inc.*, 703 F.2d 1339, 1352 (9th Cir. 1983). The tenants' rights under their leases constitute post-petition administrative claims under Section 503(b)(1)(A) of the Bankruptcy Code, 11 U.S.C. 503(b)(1)(A), the holders of which are not entitled to vote on a plan of reorganization. See *Greystone III*, 995 F.2d at 1281; *In re Distrigas Corp.*, 66 B.R. 382, 385-386 (Bankr. D. Mass. 1986).[6]

[6] Petitioner contends (Pet. 22), without elaboration, that the issue respecting the proper classification of security deposit claimants is "governed" by *Bryson Properties, XVIII*, *supra*, and *In re River Village Assocs.*, 161 B.R. 127 (Bankr. E.D. Pa. 1993). *Bryson Properties* provides petitioner no support. That opinion merely states that a class comprised of tenant security deposit claims was one of several classes proposed by a reorganization plan. 961 F.2d at 499. Because the debtor did not contend that the class of security deposit claims was impaired, the court had no occasion

In addition, the bankruptcy and district courts correctly held that, even if the tenants' security deposit claims had given them a voice in the confirmation process, the proposal by petitioner to benefit the tenants by providing them with additional interest on their deposits would not render their claims "impaired." Under Section 1124(1) of the Code, 11 U.S.C. 1124(1), a class of claims is not impaired if the plan "leaves unaltered the legal, equitable, and contractual rights to which such claim * * * entitles the holder." The proposal to pay the tenants interest on their security deposits at a rate greater than that required by law may vest a new right in the tenants, but it does so without altering their preexisting rights to a return of their security deposits with statutory interest.

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to address whether it was a proper class. Although the court in *River Village Assocs.* affirmed the voting rights of security deposit claimants whose claims (unlike those of the tenants here) would have been adversely affected by the proposed reorganization plan, it rejected the undersecured creditor's objection to that classification primarily on the ground that the undersecured creditor had failed to raise a timely objection to it. 161 B.R. at 132.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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